S. HRG. 100-713

THE ADMINISTRATION'S BUDGET PROPOSAL FOR THE SBA FOR FISCAL YEAR 1989

HEARING

BEFORE THE

COMMITTEE ON SMALL BUSINESS
UNITED STATES SENATE

ONE HUNDREDTH CONGRESS

SECOND SESSION

ON

THE ADMINISTRATION'S BUDGET PROPOSAL FOR THE SBA FOR FISCAL YEAR 1989

MARCH 22, 1988

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CONTENTS

	Page
Statement of Senators:	
Bumpers, Hon. Dale, a U.S. Senator from the State of Arkansas	1
Kasten, Hon. Robert W., Jr., a U.S. Senator from the State of Wisconsin	32
Dixon, Hon. Alan J., a U.S. Senator from the State of Illinois	36
Sasser, Hon. James R., a U.S. Senator from the State of Tennessee	37
D'Amato, Hon. Alfonse M., a U.S. Senator from the State of New York	41
Weicker, Hon. Lowell, Jr., a U.S. Senator from the State of Connecticut	33
Pressler, Hon. Larry, a U.S. Senator from the State of South Dakota	53
Statement of:	
Abdnor, Hon. James, Administrator, U.S. Small Business Administration, accompanied by Lawrence R. Rosenbaum, Comptroller; Edwin T. Holloway, Associate Administrator for Finance and Investment; and John F. Moffitt, Associate Deputy Administrator for Management and Administration, SBA	3
Price, Joann H., president, National Association of Investment Companies, Washington, DC	62

HEARING DATE

March 22, 1988:	
Afternoon session	1

THE ADMINISTRATION'S BUDGET PROPOSAL FOR THE SBA FOR FISCAL YEAR 1989

TUESDAY, MARCH 22, 1988

U.S. SENATE,
COMMITTEE ON SMALL BUSINESS,
Washington, DC.

The Committee met, pursuant to notice, at 2:05 p.m., in room SR-428A, Russell Senate Office Building, Hon. Dale Bumpers (Chairman of the Committee) presiding.

STATEMENT OF HON. DALE BUMPERS, A U.S. SENATOR FROM THE STATE OF ARKANSAS

The CHAIRMAN. Today the Committee will examine the President's 1989 budget proposal for the SBA. I welcome the Administrator, Senator Abdnor, and JoAnn Price, president of the National Association of Investment Companies, who will explain the effects of the budget proposal on the Minority Enterprise Small Business Investment Company industry.

First, the President's budget for SBA offers no real surprises. It is very similar to the proposal offered last year. Although I am pleased that the Administration has again requested that Congress fund the agency at near-1988 levels, and retain the bulk of its finance and management assistance programs. I am concerned with the proposal again to raise revenue through substantial user fees for most programs, and to produce false budget savings through the sale of SBA loan assets. Those same user fee and asset sale proposals were rejected by the Members of this Committee and the Appropriations Committee in creating the fiscal year 1988 budget for the agency. I remain concerned that the user fees are simply a back-door tax increase focused on a specific group, small business people.

The President requests a total of $404 million in budget authority for SBA, a decrease of about $10 million from the 1988 appropriated level. The Administration proposes to eliminate all direct lending programs which provide essential resources for veterans, the handicapped, and the economically disadvantaged who hope to fulfill the American dream of business ownership. Veterans, for example, used the entire $19 million provided to them in direct loans last year, and the handicapped are often lined up around the block waiting for funds.

The MESBICs also receive direct lending from SBA by the purchase of preferred securities at a 3 percent subsidized interest rate for the first 5 years. SBA says the subsidy is no longer needed by

the MESBIC industry, and this budget would require MESBICs to compete with regular SBICs for financing from a fixed amount of guaranty authority. I am concerned that this proposal is ill-thought out and will not allow adequate funding for both MESBICs and SBICs. I look forward to Ms. Price's comments on the issues.

This Committee is required to submit its views on the budget to the Senate Budget Committee by March 25. In that submission we are asked to address the new initiatives and deficit reduction measures that the Committee intends to pursue in the coming year. One initiative mentioned in the Administration's proposal which I would like the Committee to examine carefully is the plan to enhance the resource available to the Minority Small Business/Capital Ownership Development program, by transfer of the Minority Business Development Agency from the Commerce Department to SBA.

S. 1993, the bill I introduced along with Senators Weicker and Kerry to reform the 8(a) Program, makes many needed improvements to the 8(a) Program which will necessitate increased staffing and training in the field, and could produce a very effective program to assist socially and economically disadvantaged small businesses. Combining MBDA's Program and expertise with SBA's may enhance both.

I am hesitant, however, to endorse the transfer since no implementation plan was ever brought forward last year following the urgings of this Committee for such a plan, and in light of Senator Kerry's introduction of legislation to give MBDA statutory authority at the Commerce Department.

Turning to the revenue producing side of the budget request, the Administration has again proposed an even longer list of user fees than last year, as well as sale of most of SBA's loan portfolios which helps support the Business Loan and Investment Fund, the primary SBA revolving fund in the Treasury. The proposal to sell off most of the business loan assets and all of the disaster loan and 503/development company loan portfolios is of questionable merit, even though SBA's financial advisor, Paine Webber, has reported that the expected return on such sales should be much higher than predicted last year by the agency.

Even if returns as high as 70 to 75 percent can be achieved, I question whether it is wise to sell off the assets today without anticipating the obvious need to return to the Appropriations Committee in the near future to replenish the loan funds which will have no income from principal or interest payments, or are asset sales just another way of dismantling unwanted loan programs which the Administration has no desire to fund in the future?

I want to ask the Administrator what level of appropriations will be required for 1990 or 1991 if we carry out this asset sale, and whether he believes "President Bush" would request such funding.

Alan Greenspan, Chairman of the Federal Reserve Board, told the Budget Committee at its recent hearing that he, "would be troubled by the extensive use of asset sales as a long run deficit reduction strategy," and that, "merely shifting the ownership of an asset from the Government to the private sector has little effect on overall credit demands. Moreover, it produces only a one-time budget savings." Chairman Greenspan's words of warning should

be heeded, and the Administration should support longer-run privatization proposals along the lines of S. 1929, our bill to create COSBI, the Corporation for Small Business Investment.

Senator Weicker and I introduced the COSBI legislation with the backing of several Members of this Committee. It provides a variation on the Administration's straight asset sale theme. By turning over the day-to-day activities associated with administering the SBIC Program to a privately-owned, Government-sponsored corporation which can seek funding in the private capital markets, COSBI allows the SBIC industry a guaranteed source of future funding and allows the Government the chance to participate in the future growth of the industry. Although we cannot estimate at this time the exact budget impact COSBI would generate, we are certain that it has the potential to produce significant budget savings through the replacement of SBA finance and investment staff by private management, as well as the elimination of SBA's future contingent liability on SBIC-guaranteed debentures.

I hope the Budget Committee will seriously consider the COSBI proposal as a sounder form of asset sales for the SBA than that proposed in the 1988 budget proposal.

I might also say at this point, Jim, that I really cannot understand the administration's objection to COSBI because it seems to me that it is right down their alley, based on their commitment to or seeming almost obsession with privatization of everything.

But in any event, Senator Abdnor, we are most honored to have you with us and look forward to hearing your testimony.

STATEMENT OF HON. JAMES ABDNOR, ADMINISTRATOR, U.S. SMALL BUSINESS ADMINISTRATION, ACCOMPANIED BY LAWRENCE R. ROSENBAUM, COMPTROLLER; EDWIN T. HOLLOWAY, ASSOCIATE ADMINISTRATOR FOR FINANCE AND INVESTMENT; AND JOHN F. MOFFITT, ASSOCIATE DEPUTY ADMINISTRATOR FOR MANAGEMENT AND ADMINISTRATION, SBA

Senator ABDNOR. Thank you, Mr. Chairman.

We appreciate the invitation to discuss with you the President's Fiscal Year 1989 Budget Proposal for the SBA. It looks like I brought my whole army with me. I have John Moffitt to my left who is the Associate Deputy Administrator for Management and Administration; Edwin Holloway, the Associate Administrator for Finance and Investment; and Larry Rosenbaum, our Comptroller. Hopefully, with their help, we will be able to answer some of the tougher questions that might come up here. From the sound of your opening statement, I had better be prepared.

So we are looking forward to the chance to talk about our budget.

The CHAIRMAN. Well, as I say, staff is a lot tougher than I am.

Senator ABDNOR. Mr. Chairman, I just want to give you a brief overview of my statement, and I would like to request that my entire written statement be made a part of the record.

The CHAIRMAN. It will be.

Senator ABDNOR. Before discussing the Fiscal Year 1989 Budget Proposal, Mr. Chairman, I would just like to make some general comments about the agency and to highlight some of the initiatives

I have undertaken since becoming Administrator on March 23 of last year. It seems like the year has slipped by rather rapidly.

But I think I made it known at that time that I was not going to become Administrator simply to be a caretaker, nor did I become Administrator to preside over the dismantling of the agency. My position is and is going to continue to be one of seeking to enhance SBA's assistance to small businesses within the parameters set by limited and diminishing resources.

We must continue to find ways of doing more with less. That has become kind of a slogan of ours at SBA. Every program must be thoroughly examined to ensure that the Government is getting maximum benefit for each dollar spent, and that the intended beneficiaries receive effective and efficient assistance.

With that in mind, I did begin a series of initiatives which have strengthened the agency, and in turn, provided significant support to small business, all within existing budget authority. I want you to keep that in mind. Program or policy areas receiving particular emphasis include expansion of our international trade activity to further help small businesses compete in the international marketplace, the creation of a program to enhance economic development in depressed rural areas, development of a Young Entrepreneurs Program and the bolstering of our commitment to assist the economically and socially disadvantaged of our Nation.

Now, on that point, let me emphasize that we are working to guarantee the strongest of commitments to assist the economically and socially disadvantaged of our Nation. I commissioned a study by the National Association of Public Administration to identify weaknesses in our Minority Small Business/Capital Ownership Development Program, and have increased the staffing of that office.

We are working to eliminate the abuses in the 8(a) Program and to ensure program integrity. I will settle for nothing less than a program that functions as Congress intended, effectively and efficiently.

Furthermore, we have increased our emphasis on training to facilitate employment development. As a major part of this emphasis, we have instituted mandatory training for our finance and investment personnel. We have significantly enhanced our career development and employee suggestion programs. We have also expanded our computerized internal control review program to better monitor agency services to the small business community.

These accomplishments have been achieved within our budgetary constraints and serve to improve the level of service provided by the SBA. We feel that the agency is doing its very best to provide the most to small business while doing our part to ease the budget deficit.

Our fiscal 1989 budget submission reflects these goals. I would like to provide a brief overview of our budget request. In an effort to improve the management of our credit programs and to reduce the cost of these programs, we are proposing to, first, reduce SBA's participation percentage on the guaranteed loans from 90 to 75 percent on all loans made over $75,000, and this will be phased in over 5 years; second, to determine the subsidy value of our loan programs and meet our fiscal year 1989 receipt target by selling assets; third, terminate all direct loan assistance; fourth, increase

interest rates on disaster loans to the Treasury cost of money plus 1 percent, and provide assistance only to those who cannot obtain credit elsewhere.

In addition, we are proposing the following: first, that the Pollution Control Contract Guarantee Program be terminated due to lack of demand for this assistance; second, the establishment of users fees throughout the agency and an adjusting of the interest rate structure resulting in revenue increases of $23.2 million; lastly, the consolidation of the Minority Business Development Agency into the Minority Small Business activity of SBA. This includes the transfer of 242 full time equivalent positions and $40.1 million in budget authority.

This concludes my brief overview, and I will be pleased to answer your questions.

And I am awfully happy to see Senator Kasten, who I have not seen for some time.

[The prepared statement of Senator Abdnor follows:]

SBA U.S. Small Business Administration Washington, DC 20416

STATEMENT OF

JAMES ABDNOR

ADMINISTRATOR

U.S. SMALL BUSINESS ADMINISTRATION

BEFORE THE

COMMITTEE ON SMALL BUSINESS

UNITED STATES SENATE

MARCH 22, 1988

MR. CHAIRMAN, MEMBERS OF THE COMMITTEE, I AM PLEASED TO DISCUSS WITH YOU TODAY THE PRESIDENT'S SMALL BUSINESS ADMINISTRATION BUDGET PROPOSAL FOR FISCAL YEAR 1989 AND TO ANSWER YOUR QUESTIONS CONCERNING THE ADMINISTRATION OF THE AGENCY'S PROGRAM. ACCOMPANYING ME TODAY ARE LAWRENCE R. ROSENBAUM, OUR COMPTROLLER, EDWIN T. HOLLOWAY, ASSOCIATE ADMINISTRATOR FOR FINANCE AND INVESTMENT, AND JOHN F. MOFFITT, ASSOCIATE DEPUTY ADMINISTRATOR FOR MANAGEMENT AND ADMINISTRATION.

I WOULD LIKE TO HAVE MY STATEMENT MADE A PART OF THE COMMITTEE HEARING RECORD.

REVIEW OF AGENCY

BEFORE DISCUSSING THE FISCAL YEAR 1989 BUDGET PROPOSAL, I WOULD LIKE TO REVIEW THE OVERALL STATUS OF THE AGENCY AND TO HIGHLIGHT SOME INITIATIVES TAKEN SINCE I BECAME ADMINISTRATOR MARCH 23RD OF LAST YEAR.

I DID NOT BECOME ADMINISTRATOR TO BE A CARETAKER. NOR DID I BECOME ADMINISTRATOR TO PRESIDE OVER THE DISMANTLING OF THE AGENCY. MY POSITION IS AND WILL CONTINUE TO BE ONE OF SEEKING TO ENHANCE SBA'S ASSISTANCE TO SMALL BUSINESSES WITHIN THE PARAMETERS SET BY LIMITED AND DIMINISHING RESOURCES. WE MUST CONTINUE TO FIND WAYS OF DOING MORE WITH LESS. EVERY PROGRAM MUST BE THOROUGHLY EXAMINED TO ENSURE THAT THE GOVERNMENT IS GETTING MAXIMUM BENEFIT FOR EACH DOLLAR SPENT AND THAT THE INTENDED BENEFICIARIES RECEIVE EFFECTIVE AND EFFICIENT ASSISTANCE.

WITH THAT IN MIND, I BEGAN A SERIES OF INITIATIVES WHICH HAVE STRENGTHENED THE AGENCY AND IN TURN PROVIDED SIGNIFICANT SUPPORT TO SMALL BUSINESS, ALL WITHIN EXISTING BUDGET AUTHORITY.

PROGRAM OR POLICY AREAS RECEIVING PARTICULAR EMPHASIS INCLUDE THE FOLLOWING: EXPANSION OF OUR INTERNATIONAL TRADE ACTIVITY TO FURTHER HELP SMALL BUSINESS COMPETE IN THE INTERNATIONAL MARKETPLACE, CREATION OF A PROGRAM TO ENHANCE ECONOMIC DEVELOPMENT IN DEPRESSED RURAL AREAS, DEVELOPMENT OF A YOUNG ENTREPRENEUR'S PROGRAM AND THE BOLSTERING OF OUR COMMITMENT TO ASSIST THE ECONOMICALLY AND SOCIALLY DISADVANTAGED OF OUR NATION.

INTERNATIONAL TRADE

ONE OF MY VERY FIRST ACTIONS UPON BECOMING SBA ADMINISTRATOR WAS TO ORDER A COMPLETE REVIEW OF OUR INTERNATIONAL TRADE PROGRAM. SPURRED ON BY THE NEED TO REDUCE THE NATION'S TRADE DEFICIT AS WELL AS BY A DESIRE TO MAKE SURE SMALL BUSINESS HAS AN EQUAL OPPORTUNITY TO COMPETE IN EXPORT MARKETS, I DETERMINED THAT MORE RESOURCES WOULD HAVE TO BE MADE AVAILABLE FOR THIS PROGRAM.

THOSE RESOURCES WERE FOUND WITHIN EXISTING PROGRAM FUNDING LEVELS. THE RESULT IS A VERY MUCH IMPROVED PROGRAM WITHOUT REQUIRING ADDITIONAL FUNDING FROM CONGRESS.

OUR EFFORTS INCLUDE:

- DEVELOPMENT OF THE EXPORTER'S GUIDE TO FEDERAL RESOURCES FOR SMALL BUSINESS. OVER 20,000 COPIES OF THIS BOOKLET HAVE ALREADY BEEN DISTRIBUTED.

- IMPLEMENTING TEN TWO-DAY REGIONAL INTERNATIONAL TRADE FORUMS. THE FIRST FORUM HELD IN PHILADELPHIA WAS VERY WELL ATTENDED. FORUMS TO BE HELD THIS MONTH ARE ON MARCH 16 AND 17 IN LOS ANGELES AND ON MARCH 24 AND 25 IN ATLANTA.

IN ADDITION, THE FOLLOWING OBJECTIVES ARE BEING PURSUED:

- SPONSORING AND SUPPORTING 700 SATELLITE INTERNATIONAL TRADE CONFERENCES ACROSS THE NATION.

- COMPILING AND PRODUCING INDIVIDUAL INTERNATIONAL TRADE RESOURCE SUMMARIES FOR ALL FIFTY STATES.

- CO-SPONSORING WITH THE DEPARTMENT OF COMMERCE NINE SMALL BUSINESS MATCHMAKER TRADE MISSIONS ABROAD.

- CONDUCTING SBA-LED TRADE MISSIONS UNDERWRITTEN BY THE PRIVATE SECTOR TO JAPAN, KOREA AND AUSTRALIA.

RURAL DEVELOPMENT

RURAL DEVELOPMENT IS ANOTHER SIGNIFICANT INITIATIVE UNDERTAKEN AT THE SBA. WE RECOGNIZE THE IMPORTANT ROLE RURAL AREAS PLAY IN OUR ECONOMY. FURTHER, WE RECOGNIZE THAT A MORE FOCUSED EFFORT MUST BE MADE BY ALL LEVELS OF GOVERNMENT TO COME TO THE ASSISTANCE OF RURAL AMERICA. WE DON'T NEED NEW PROGRAMS. WE JUST NEED TO DO A BETTER JOB OF LETTING RURAL AMERICA KNOW WHAT IS ALREADY AVAILABLE TO THEM. UNDER SBA'S LEADERSHIP, AGENCIES OF THE FEDERAL GOVERNMENT HAVE BEEN BROUGHT TOGETHER TO PROVIDE THAT MUCH NEEDED COORDINATION.

SBA IS DOING THE FOLLOWING:

- IDENTIFYING UNIQUE RURAL SMALL BUSINESS NEEDS AND EMPLOYING APPROPRIATE REGIONAL STRATEGIES.

- MAKING AN INVENTORY OF PROGRAMS AVAILABLE THAT MEET THE NEEDS OF RURAL ECONOMIC DEVELOPMENT.

- EVALUATING EACH REGIONAL DELIVERY SYSTEM IN ORDER TO MAKE RECOMMENDATIONS TO IMPROVE AGENCY EFFECTIVENESS IN RURAL AREAS.

- IDENTIFYING RURAL AREAS FOR SPECIAL ASSISTANCE.

TO ACCOMPLISH THESE AIMS WE HAVE HELD FIVE FIELD HEARINGS WHERE GOVERNORS, MAYORS, BUSINESS LEADERS, BANKERS, AND SMALL BUSINESS OWNERS HAVE IDENTIFIED BOTH LOCAL ECONOMIC PROBLEMS AS WELL AS SUGGESTIONS FOR THEIR RESOLUTION. I PRESENTED THESE RECOMMENDATIONS TO THE NATION'S GOVERNORS AT THE NATIONAL GOVERNORS ASSOCIATION MEETING IN WASHINGTON, D.C. LATE LAST MONTH.

SBA PLANS TO HOLD RURAL ECONOMIC DEVELOPMENT CONFERENCES IN ALL FIFTY STATES THIS YEAR. WE ALSO PLAN TO PUBLISH A RESOURCE GUIDE FUNDED BY SOUTHWESTERN BELL WHICH DESCRIBES ALL OF THE FEDERAL AND STATE PROGRAMS FOR RURAL DEVELOPMENT.

MINORITY SMALL BUSINESS/CAPITAL OWNERSHIP DEVELOPMENT

VERY FEW WOULD DENY THE URGENT NEED TO RENEW AND REVITALIZE SBA'S MINORITY SMALL BUSINESS AND CAPITAL OWNERSHIP DEVELOPMENT PROGRAM. CONGRESS LONG-AGO RECOGNIZED THE IMPORTANCE OF ENSURING MINORITIES EQUAL ACCESS AND PARTICIPATION IN THE FREE ENTERPRISE SYSTEM. I SHARE THAT VISION. AND AS A SUPPORTER OF THIS PROGRAM, I WAS APPALLED AT THE HEADLINES OF NEWSPAPERS NATIONWIDE REPORTING ABUSES.

EARLY IN MY TENURE I COMMISSIONED A STUDY BY THE NATIONAL ASSOCIATION OF PUBLIC ADMINISTRATION (NAPA) TO IDENTIFY WEAKNESSES IN OUR MINORITY SMALL BUSINESS/CAPITAL OWNERSHIP DEVELOPMENT PROGRAM. THAT STUDY IS COMPLETE AND MANY CHANGES HAVE BEEN INITIATED AS A RESULT OF THOSE RECOMMENDATIONS. WE ARE STRIVING TO ELIMINATE THE ABUSES IN THE 8(A) PROGRAM AND ENSURE THAT IT WORKS EFFECTIVELY. WE ARE WORKING TO GUARANTEE THE COMMITMENT MADE TO ASSIST THE ECONOMICALLY AND SOCIALLY DISADVANTAGED OF OUR NATION.

WE HAVE MADE A NUMBER OF OTHER IMPROVEMENTS:

- WE HAVE REORGANIZED THE OFFICE TO EMPHASIZE A CONSISTENT AND IMPARTIAL ADMINISTRATION OF THE PROGRAM.

- WE HAVE INCREASED STAFF POSITIONS BY 25% TO ACCOMPLISH THIS GOAL.

- WE ARE IN THE PROCESS OF DEVELOPING NEW REGULATIONS: REGARDING ELIGIBILITY FOR CONCERNS OWNED BY INDIAN TRIBES OR NATIVE AMERICAN CORPORATIONS, REGULATIONS TO IMPOSE STRICTER ELIGIBILITY CRITERIA AND CONTRACT SUPPORT REQUIREMENTS, AND REGULATIONS TO IMPLEMENT PROTEST PROCEDURES IN CONJUNCTION WITH CONTRACT REQUIREMENTS COMPETED PURSUANT TO THE SMALL DISADVANTAGED BUSINESS PROGRAM AUTHORIZED BY PUBLIC LAW 99-661.

- WE HAVE TAKEN MEASURES TO REDUCE THE TIME INVOLVED IN THE 8(A) PROGRAM APPLICATION PROCESS.

- WE HAVE ESTABLISHED A REQUIREMENT THAT A PROGRAM APPLICANT MUST BE IN BUSINESS TWO FULL YEARS. WE FEEL THIS WILL RESULT IN PROGRAM PARTICIPATION BY THOSE FIRMS THAT HAVE THE GREATEST POTENTIAL FOR SUCCESS.

- WE HAVE BEEN EVALUATING DIFFERENT MEASURES TO ENSURE THAT PROGRAM PARTICIPANTS FULLY UNDERSTAND THE DEVELOPMENTAL NATURE OF THE MSB/COD PROGRAM.

- WE ARE REVIEWING A MARKETING PROPOSAL TO IMPROVE MINORITY SMALL BUSINESS' ACCESS TO PRIVATE SECTOR MARKETS.

- WE ARE STUDYING NEW WAYS TO ENCOURAGE GREATER PARTICIPATION BY PRIVATE FINANCIAL INSTITUTIONS IN THE FINANCING OF MINORITY SMALL BUSINESS.

- WE ARE DEVELOPING A COMPREHENSIVE MONITORING SYSTEM TO CONTINUE TO TRACK THE DEVELOPMENT OF FIRMS AFTER THEY LEAVE THE 8(A) PROGRAM.

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IN ADDITION, WE HAVE VIGOROUSLY PURSUED THOSE WHO HAVE VIOLATED THE LAW, SBA REGULATIONS, OR TAKEN ADVANTAGE OF OUR PROGRAMS. THE OFFICE OF THE INSPECTOR GENERAL HAS TAKEN NUMEROUS MANAGEMENT ACTIONS AS A RESULT OF THEIR AUDITS AND INVESTIGATIONS. SINCE APRIL 1, 1987, THE OIG HAS COMPLETED OVER 382 AUDITS AND 95 INVESTIGATIONS. THESE FINDINGS HAVE RESULTED IN:

- 37 INDICTMENTS
- 12 CONVICTIONS
- $36.6 MILLION IN RECOVERIES AND REDUCTIONS OF FINANCIAL RISK
- 6 SUSPENSIONS, DEBARMENTS, PERSONNEL ACTIONS, AND OTHER PROGRAM SANCTIONS
- MANAGEMENT IMPROVEMENTS IN SUCH SBA ACTIVITIES AS THE SMALL BUSINESS DEVELOPMENT CENTER PROGRAM AND THE BUSINESS LOAN PRAOGRAM.

WE HAVE FURTHER STRENGTHENED THE AGENCY, AND AT THE SAME TIME REDUCED THE COST OF OUR PROGRAMS BY: 1) INCREASING MANAGEMENT OVERSIGHT OF PROGRAMS AND ACTIVITIES TO REDUCE FRAUD AND WASTE; 2) IMPROVING EMPLOYEE PRODUCTIVITY; 3) TIGHTENING DEBT COLLECTION MEASURES;

4) EMPHASIZING PRIVATIZATION OF FEDERAL PROGRAMS; 5) IMPLEMENTING FISCALLY RESPONSIBLE CASH MANAGEMENT POLICIES; 6) LEVERAGING FEDERAL FUNDS WITH THOSE OF THE PRIVATE SECTOR; AND 7) STRENGTHENING PRUDENT LOAN-MAKING POLICIES TO ENSURE QUALITY IN LENDING.

WE HAVE SIGNIFICANTLY INCREASED OUR EMPHASIS ON TRAINING TO FACILITATE EMPLOYEE DEVELOPMENT, AND AS A MAJOR PART OF THIS EFFORT WE HAVE INSTITUTED MANDATORY TRAINING FOR OUR FINANCE AND INVESTMENT PERSONNEL TO HELP IMPROVE THE EFFICIENCY OF OUR FIELD OPERATIONS. OUR CAREER DEVELOPMENT AND EMPLOYEE SUGGESTION PROGRAMS HAVE BEEN GIVEN GREATER EMPHASIS. WE HAVE ALSO REORGANIZED THE PERSONNEL OFFICE IN ORDER TO BETTER SERVE OUR MANAGERS AND TO HELP ENSURE THAT THE AGENCY IS OPERATING MORE EFFECTIVELY AND EFFICIENTLY. WE HAVE EXPANDED OUR COMPUTERIZED INTERNAL CONTROL REVIEW (CICR) PROGRAM TO BETTER MONITOR AGENCY SERVICES TO OUR FIELD OFFICES.

ALL OF THESE ACCOMPLISHMENTS HAVE BEEN ACHIEVED WITHIN OUR BUDGETARY CONSTRAINTS WHILE AT THE SAME TIME ENABLING US TO PROVIDE A HIGH LEVEL OF SERVICE TO SMALL BUSINESSES. WE FEEL, THEREFORE, THAT THE AGENCY IS DOING ITS BEST TO PROVIDE THE MOST TO THE SMALL BUSINESS COMMUNITY WHILE ALSO DOING OUR PART TO EASE THE BUDGET DEFICIT. OUR FY 1989 BUDGET SUBMISSION REFLECTS THESE GOALS.

PROPOSED FY 1989 BUDGET

IN FY 1989 THE SBA PLANS TO IMPLEMENT ADDITIONAL MANAGEMENT, ADMINISTRATIVE, FINANCIAL, AND PRODUCTIVITY MEASURES TO FURTHER INCREASE THE QUALITY AND EFFECTIVENESS OF ASSISTANCE PROVIDED. THE PROPOSED SBA BUDGET REQUESTS $404,080,000 IN NEW BUDGET AUTHORITY AND A STAFFING LEVEL OF 4,304 FULL-TIME EQUIVALENT (FTE) POSITIONS. THIS FIGURE INCLUDES 242 FTE'S FOR THE TRANSFER OF THE MINORITY BUSINESS DEVELOPMENT AGENCY TO THE SMALL BUSINESS ADMINISTRATION.

WE ARE AGAIN REQUESTING THE ESTABLISHMENT OF USER FEES AND THE ADJUSTING OF INTEREST RATE STRUCTURES AS OPPOSED TO ANY MAJOR CUTBACK OR ELIMINATION OF PROGRAMS. TO ENSURE ECONOMIC GROWTH, THIS BUDGET PROPOSES TO ELIMINATE EXCESSIVE SUBSIDIES AND ENSURE THAT ALL PROGRAM BENEFICIARIES PAY A FAIR PRICE FOR SBA SERVICES.

SALARIES AND EXPENSES

A DIRECT APPROPRIATION OF $249,080,000 INCLUDING $40,122,000 FOR THE PROPOSED TRANSFER OF THE MINORITY BUSINESS DEVELOPMENT AGENCY (MBDA) IS REQUESTED FOR FY 1989 TO PROVIDE

FUNDS FOR SALARIES AND GENERAL EXPENSES OF THE SMALL BUSINESS ADMINISTRATION. THIS AMOUNT IS TO BE SUPPLEMENTED BY THE EXPECTED RECEIPTS OF $5,297,000 FROM PROPOSED USER FEES AND BY THE $88,228,000 IN REQUESTED TRANSFER AUTHORITY FROM THE DISASTER LOAN FUND FOR DISASTER LOAN MAKING AND DISASTER LOAN SERVICING ACTIVITIES. THESE WILL PROVIDE ADEQUATE FUNDING FOR THE PROPOSED 4,304 FULL TIME EQUIVALENT POSITIONS AND THE AGENCY'S OPERATING EXPENSES. THE COMPARABLE FIGURES FOR FY 1988 WERE: $215,832,000 IN DIRECT APPROPRIATION, AND $88,228,000 TRANSFER FROM THE DISASTER LOAN FUND.

BUSINESS LOAN AND INVESTMENT FUND

THE FY 1989 REQUEST IS FOR A DIRECT APPROPRIATION OF $130,000,000 FOR THE BUSINESS LOANS AND INVESTMENTS OF THE SMALL BUSINESS ADMINISTRATION. OUTLAYS ASSOCIATED WITH THIS REQUEST ARE ESTIMATED AT $106,036,000.

WE PROPOSE THE ELIMINATION OF BUSINESS DEVELOPMENT EXPENSE (BDE) AND ALL DIRECT LENDING. IN ADDITION, WE PROPOSE THAT THE SBA SELL APPROXIMATELY $200 MILLION OF ITS PORTFOLIO IN FY 1989 TO ACHIEVE $140,000,000 IN RECEIPTS FROM THE SALE OF BUSINESS LOAN ASSETS.

AS REQUIRED BY THE BALANCED BUDGET AND EMERGENCY DEFICIT CONTROL ACT OF 1985, THIS REQUEST ALSO CONSOLIDATES THE FEDERAL FINANCING BANK (FFB) ACCOUNT OF THE SBA WITH THE BUSINESS LOAN INVESTMENT FUND. INCLUDED IS A PROPOSAL TO SELL $330,000,000 OF THE "503" DEVELOPMENT COMPANY PORTFOLIO CURRENTLY HELD BY THE FFB. THERE WILL BE NO POSITIVE OUTLAYS ASSOCIATED WITH THE FFB ACCOUNT. INCLUDED IS $249,000,000 IN RECEIPTS FROM THE SALE OF FFB ASSETS.

THIS REQUEST ALSO PROPOSES INCREASING USER AND/OR GUARANTEE FEES. THESE ADDITIONAL REVENUES HELP OFFSET THE BUDGET AUTHORITY AND OUTLAY REQUESTS FOR THIS FUND FOR FY 1989. AN ESTIMATE OF ADDITIONAL REVENUES TO BE GENERATED IN FY 1989 IS $8,410,000. THIS REDUCTION IS INCLUDED IN THE ABOVE BUDGET AUTHORITY AND OUTLAY FIGURES.

DISASTER LOAN FUND

IN THE DISASTER PROGRAM, WE ARE REQUESTING A PROGRAM LEVEL OF $265,000,000 FOR FY 1989. THIS REQUEST INCLUDES A PROPOSAL TO ELIMINATE DISASTER LENDING TO THOSE BORROWERS WHO CAN OBTAIN "CREDIT ELSEWHERE" AND IS TO BE EFFECTIVE BEGINNING IN OCTOBER 1988. BECAUSE OF THE UNCERTAINTY OF DEMAND FOR

THIS PROGRAM. TOTALLY ACCURATE PROJECTIONS OF LENDING LEVELS ARE NOT POSSIBLE. THE REQUESTED LEVEL SHOULD PROVIDE SUFFICIENT RESOURCES TO MEET ALL ANTICIPATED DEMANDS FOR A NORMAL YEAR.

THIS REQUEST PROPOSES THE SELLING OF SBA'S DISASTER PORTFOLIO, BEGINNING IN FY 1989. ESTIMATED SALES OF $550,000,000 OF LOAN PRINCIPAL ARE EXPECTED TO REFLECT RECEIPTS OF $321,000,000 IN FY 1989.

SURETY BOND GUARANTEE REVOLVING FUND

THE BUDGET REQUEST FOR THE SURETY BOND GUARANTEES OF THE SMALL BUSINESS ADMINISTRATION IS FOR $11,000,000 IN DIRECT APPROPRIATIONS. OUTLAYS ASSOCIATED WITH THIS REQUEST ARE ESTIMATED AT $10,700,000.

THIS REQUEST PROPOSES INCREASES IN REVENUES FROM FEES OF $4,500,000 THAT ARE REMITTED TO SBA. THESE ADDITIONAL REVENUES TO THE FUND REDUCE THE REQUIREMENTS FOR BUDGET AUTHORITY AND OUTLAYS IN FY 1989.

LEASE GUARANTEE REVOLVING FUND

THIS BUDGET REQUESTS NO DIRECT APPROPRIATION TO PAY THE CLAIMS RESULTING FROM LEASES GUARANTEED BY THE SMALL BUSINESS ADMINISTRATION IN PRIOR FISCAL YEARS. THE UNOBLIGATED BALANCE CARRIED FORWARD FROM FY 1988 WILL BE SUFFICIENT TO FINANCE FY 1989 ACTIVITY. OUTLAYS ASSOCIATED WITH THIS REQUEST ARE ESTIMATED AT $700,000.

THE REQUEST PROPOSES LEGISLATION TO CONSOLIDATE THIS FUND INTO THE BUSINESS LOAN AND INVESTMENT FUND TO PAY CLAIMS RESULTING FROM LEASES GUARANTEED BY THE SBA IN PRIOR YEARS.

POLLUTION CONTROL EQUIPMENT CONTRACT GUARANTEES REVOLVING FUND

THIS BUDGET REQUEST IS FOR $14,000,000 IN DIRECT APPROPRIATIONS, TO PAY THE ANTICIPATED LIQUIDATION OF DEFAULTED POLLUTION CONTRACTS APPROVED BY THE SMALL BUSINESS ADMINISTRATION IN FY 1988 AND PRIOR YEARS. OUTLAYS ASSOCIATED WITH THIS REQUEST ARE ALSO ESTIMATED AT $14,000,000.

THIS REQUEST PROPOSES THE TERMINATION OF NEW GUARANTEES FOR THIS PROGRAM IN FY 1989 BECAUSE THE LACK OF ACTIVITY NO LONGER JUSTIFIES A SEPARATE IDENTIFIABLE FUND. TAX-EXEMPT BONDS WERE CURTAILED BY THE 1986 TAX REFORM ACT AND FINANCING NO LONGER IS AS ADVANTAGEOUS AS IT WAS BEFORE THIS LEGISLATION. SINCE 1983 ONLY 29 FINANCINGS FOR A TOTAL OF $56 MILLION HAS BEEN GUARANTEED. THEREFORE, THE SBA WILL ONLY SERVE TO CONTINUE PAYING DEFAULT CLAIMS RESULTING FROM GUARANTEES ENTERED INTO PRIOR TO FY 1989.

THIS REQUEST PROPOSES THE CONSOLIDATION OF THIS FUND INTO THE BUSINESS LOAN AND INVESTMENT FUND. SINCE THERE WILL BE NO NEW GUARANTEES ISSUED, THE FUND WOULD BE RESPONSIBLE FOR THE PAYMENT OF CLAIMS FROM PRIOR GUARANTEES.

FY 1989 INITIATIVES

IN FY 1989 THE SBA PLANS TO IMPLEMENT MANAGEMENT, ADMINISTRATIVE, FINANCIAL, AND PRODUCTIVITY MEASURES TO ENHANCE THE QUALITY AND EFFECTIVENESS OF THE ASSISTANCE PROVIDED TO SMALL BUSINESS. THESE MEASURES INCLUDE:

SALE OF LOAN ASSETS

IN AN EFFORT TO MORE EFFECTIVELY MANAGE OUR CREDIT PROGRAMS, OUR FY 1989 BUDGET PROPOSES THE SALE OF ASSETS BEGINNING IN FY 1989. THIS BUDGET PROPOSAL ESTIMATES RECEIPTS FROM ASSET SALES OF $710 MILLION TO OFFSET FY 1989 OUTLAYS, INCLUDING SALES OF ASSETS HELD BY THE FEDERAL FINANCING BANK (FFB).

REDUCTION OF SBA'S EXPOSURE ON GUARANTEE LOANS TO 75% AND THE CORRESPONDING DOLLAR THRESHOLD TO $75,000 BY 1993

LOWERING THE GUARANTEE PERCENTAGE WILL SUBSTANTIALLY REDUCE FUTURE BUDGETARY REQUIREMENTS. SBA WILL BE GUARANTEEING A SMALLER PERCENTAGE AGAINST LOSS ON EACH LOAN DOLLAR, THEREBY LOWERING PROGRAM COST PER DOLLAR OF LOAN. ALSO, A LOWER GUARANTEE PERCENTAGE SHOULD ENCOURAGE MORE QUALITY LENDING AND LOWER LOSS RATES. AT THE SAME TIME, WE FEEL THAT THIS LEVEL OF FEDERAL PARTICIPATION IS SIGNIFICANT ENOUGH TO ASSURE CONTINUED LENDING BY PRIVATE FINANCIAL INSTITUTIONS TO SMALL BUSINESSES.

ELIMINATION OF ALL DIRECT LENDING

BECAUSE OF THE FIRM BELIEF THAT LEGITIMATE CREDIT DEMANDS OF THE SMALL BUSINESS PERSON CAN BE ADDRESSED THROUGH THE GUARANTEED LENDING PROGRAMS, WE HAVE REQUESTED THE ELIMINATION OF ALL DIRECT LOANS IN FY 1989. CURRENTLY, DIRECT LENDING ACCOUNTS FOR ONLY A VERY SMALL PORTION OF THE FINANCIAL ASSISTANCE DELIVERED TO SMALL BUSINESS BORROWERS. IN FY 1987, FOR EXAMPLE, 97 PERCENT OF LOAN DOLLARS WERE IN THE FORM OF GUARANTEED LOANS.

DISASTER PROGRAM CHANGES

THE PROPOSED BUDGET INCLUDES A REQUEST TO INCREASE THE INTEREST RATE CHARGED ON DISASTER LOANS FROM A HEAVILY SUBSIDIZED RATE TO A RATE WHICH REFLECTS THE COST OF MONEY TO THE GOVERNMENT AT THE TIME OF THE DISASTER, PLUS ONE PERCENT TO COVER ADMINISTRATIVE EXPENSES. ALSO, IT IS PROPOSED THAT IN FY 1989, DISASTER LOAN ASSISTANCE WILL NOT BE AVAILABLE TO THOSE WHO CAN OBTAIN CREDIT ELSEWHERE. THESE CHANGES ARE CONSISTENT WITH THE GENERAL ACCOUNTING OFFICE (GAO) FINDINGS AND WOULD ENSURE THAT THE TAX PAYERS FUNDS ARE NOT USED TO PROVIDE UNNECESSARY SUBSIDIES.

ELIMINATION OF POLLUTION CONTROL PROGRAM

TERMINATING THIS PROGRAM WOULD HAVE AN INSIGNIFICANT EFFECT ON THE FIGHT AGAINST POLLUTION OR THE ABILITY OF THE SMALL BUSINESS SECTOR TO MEET ESTABLISHED ANTI-POLLUTION STANDARDS. FROM FY 1983 TO THE PRESENT ONLY 29 FINANCING ACTIONS HAVE OCCURRED UNDER THIS PROGRAM.

ESTABLISH NEW USER FEES ON RECIPIENTS OF SBA'S ASSISTANCE AND INCREASE EXISTING USER FEES WHERE APPROPRIATE

THE FY 1989 BUDGET PROPOSAL PROVIDES FOR A $23.2 MILLION INCREASE IN REVENUES. OF THIS AMOUNT $5.3 MILLION WOULD BE FROM USER FEES CHARGED TO RECIPIENTS OF ASSISTANCE PROGRAMS; $8.4 MILLION IS TO BE GENERATED BY THE BUSINESS LOAN PROGRAM; $4.5 MILLION BY THE SURETY BOND PROGRAM FROM INCREASES IN FEE REVENUES AND $5 MILLION FROM THE DISASTER LOAN PROGRAM FROM THE INCREASE OF THE EXISTING SUBSIDIZED INTEREST RATE TO THE TREASURY COST OF MONEY.

PHASE OUT OF FEDERAL FUNDING OF THE SBDC PROGRAM

WE BELIEVE THAT THE ORIGINAL LEGISLATIVE INTENT WAS ONLY TO STIMULATE CREATION OF SUCH CENTERS AS UNIVERSITIES.

TRADE ORGANIZATIONS, AND BY OTHER NON-PROFIT GROUPS TO MEET THE LOCAL SMALL BUSINESS TRAINING AND BUSINESS SERVICES NEEDS--NOT TO CREATE ANOTHER SUBSIDY PROGRAM WITH ITS OWN PERMANENT FEDERAL BUREAUCRACY AND CONSTITUENCY. CONTINUED FEDERAL INVOLVEMENT MAY IN THE LONG RUN DISCOURAGE FURTHER DEVELOPMENT OF SUCH NEEDED SERVICES WITHIN THE PRIVATE SECTOR, AS THE FEDERAL SUBSIDIES WOULD CONTINUE TO ALLOW THE RECIPIENTS TO SET THEIR FEES AT BELOW ACTUAL COST LEVELS, THUS EFFECTIVELY KEEPING PRIVATE BUSINESSES OUT OF THE MARKETPLACE.

TRANSFER OF THE MINORITY BUSINESS DEVELOPMENT AGENCY (MBDA) TO THE SBA.

THIS TRANSFER WILL PROVIDE THE FOCUSED, ONE-STOP ASSISTANCE THAT IS NEEDED BY MINORITY SMALL BUSINESS TO MAKE ASSISTANCE MORE ACCESSIBLE. INCLUDED IN THIS PROPOSAL IS THE TRANSFER OF $40.1 MILLION IN FINANCIAL RESOURCES, INCLUDING $24 MILLION IN GRANT AUTHORITY AND 242 FTES.

ELIMINATION OF THE SECTION 7(J) PROGRAM.

THE CONTINUED FUNDING FOR THIS PROGRAM IS CONSIDERED A DUPLICATION OF THE TECHNICAL SERVICES PROVIDED UNDER THE GRANT AUTHORITY INCLUDED WITH THE MBDA TRANSFER.

TERMINATION OF BUSINESS DEVELOPMENT EXPENSE (BDE)

WE BELIEVE THAT FUNDING FOR BDE SHOULD BE TERMINATED BECAUSE OF THE INCREASED AVAILABILITY OF PRIVATE CAPITAL TO 8(A) FIRMS TO PURCHASE EQUIPMENT, THE WILLINGNESS OF BUYING ACTIVITIES TO AWARD 8(A) CONTRACTS AT A REASONABLE PRICE, AND BECAUSE OF THE HIGH PROPENSITY FOR ABUSE AS DOCUMENTED BY THE INSPECTOR GENERAL.

IN CONCLUSION, WE ARE MEETING THE CHALLENGE TO HELP SMALL BUSINESS AND THE AGENCY FACE THE FUTURE. I HAVE BROUGHT CONSISTENCY, QUALITY, AND FAIRNESS TO ALL SBA OPERATIONS THROUGH COMMUNICATION AND CONSTANT DEDICATION TO EXCELLENCE. THE SBA IS NOT ONLY HERE TO STAY BUT WE ARE CONTINUALLY SEEKING NEW WAYS TO ENCOURAGE SMALL BUSINESSES. WE ARE COMMITTED TO DOING MORE AT LESS EXPENSE FOR THE TAXPAYER AND TO MAKING SBA PROGRAMS THE MOST EFFICIENT AND EFFECTIVE POSSIBLE.

(1) The proposed elimination of the direct loan programs for veterans, handicapped, and Minority Small Business Investment Companies (MESBICs).

RESPONSE:

Because of the firm belief that legitimate credit demands of the small business person can be addressed through the guaranteed lending programs, we have requested the elimination of all direct loans in FY 1989. Currently, direct lending accounts for only a very small portion of the financial assistance delivered to small business borrowers. In FY 1987, for example, 97 percent of loan dollars were in the form of guaranteed loans.

This proposal would benefit both the small business person and the taxpayer considering the significant cost of direct lending and the relative minimal impact direct lending has had compared to our guarantee lending.

For the borrower it would mean that all SBA general business loans would be made through banks. For small businesses, borrowing from a bank instead of from the SBA would mean that they could develop a relationship and a track record with a private sector lender rather than with a government agency.

For the taxpayer, guaranteed loans are preferable to direct because they cost the government less. In the short run they require an outlay of federal funds only when an uncured default occurs and SBA must purchase the loans from a bank, whereas a direct loan requires an outlay of government funds each time a loan is made.

(2) The proposed sale of SBA assets in FY 1989.

RESPONSE:

In an effort to more effectively manage our credit programs, our FY 1989 budget proposes the sale of assets beginning in FY 1989. This budget proposal estimates receipts from asset sales of $710 million to offset FY 1989 outlays, including sales of assets held by the Federal Financing Bank (FFB).

The assets sales would be conducted according to the following schedule:

Loan Sale	Revenues	Return	Assumptions
BUSINESS LOANS			
$200 M	$140 M	70%	Sell best of our current portfolio
DISASTER LOANS			
$550 M	$321 M	58%	Sell our current and past-due portfolio
FFB-503 DEVELOPMENT COMPANY LOANS			
$330 M	$249 M	75%	Sell loans in portfolio

These sales, while making a substantial contribution to the reduction of the overall federal deficit, will also produce:

1. Substantial reductions in our future loan servicing costs and, in turn, resource requirements; and

2. Factual data for use in estimating the true subsidy levels for the various SBA credit programs.

In preparation for these sales we contracted with PaineWebber last year to complete a study on this issue. The consultant analyzed the portfolio and concluded that the SBA loan assets could be sold at competitive prices.

(3) The proposed transfer of MBDA to SBA and SBA's specific plans for consolidation of MBDA's programs with SBA's MSB/COD Programs

RESPONSE:

This budget proposes to consolidate all the government minority business development activities within SBA by transferring the entire minority business programs currently administered by the Minority Business Development Agency (MBDA) in the Department of Commerce, to SBA. The FY 1989 budget includes the transfer of 242 full-time equivalent positions and $40.1 million in budget authority, including $24 million in grant authority.

The greatest beneficiary of the long overdue consolidation of minority business efforts is the minority business sector itself. In addition, this action will increase the effectiveness of government assistance to the minority business community through improved coordination of program delivery systems. The extensive network of Minority Business Development Centers (MBDCs) will provide SBA with a more commanding presence in minority communities, where 83% of minority businesses are located, enabling it to be more responsive to their real problems and needs. In turn, the MBDCs, by becoming more sensitive to the 8(a) and other SBA program objectives and the problems faced by the participants will provide more effective assistance to these firms and improve the rate of successful experiences with SBA programs.

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(4) The imposition of user fees on the agency's management assistance programs.

RESPONSE:

The FY 1989 budget proposal provides for a $23.2 million increase in revenues. Of this amount $5.3 million would be from user fees charged to recipients of assistance programs; $8.4 million is to be generated by the business loans program; $4.5 million by the surety bond program from increases in fee revenues and $5 million from the disaster loan program from the increase of the existing subsidized interest rate to the Treasury cost of money.

The proposed fee structure will:

1. Improve agency programs through increased efforts by managers to make their programs more cost effective.

2. Induce future development of small business oriented services by state/local government, university, and private industry owned and operated organizations (by eliminating the "free" alternate services supplied by the Federal Government).

(5) The proposed reduction and eventual phase out of funding from the Small Business Development Center (SBDC) program.

RESPONSE:

This budget proposes the gradual phase-out of the federal role in SBDC funding.

The fiscal year 1989 budget requests $26 Million in new authority for support of the currently established and operating Small Business Development Centers (SBDCs). Such centers are now located in 43 states, The District of Columbia, Puerto Rico and the Virgin Islands. Four additional centers are currently in various stages of planning (Montana, New Mexico, Arizona and Maryland).

The administration proposes to phase out federal funding for "Matured" SBDCs over a three year period, but allows the programs that are at the start-up phase to continue to receive federal funding through 1992.

This should not be viewed as a major shift in program direction. We believe that the original legislative intent was only to stimulate creation of such centers by universities, by trade organizations, and by other non-profit groups to meet the local small business training and business development needs, not to create a permanent subsidy program.

The CHAIRMAN. Senator Kasten, do you have a statement you would like to put in the record?

I was wondering, Jim, if you were going to overlook somebody that weighs 300 pounds, 6 feet 6.

Senator ABDNOR. Well, he looked awfully small there.

Senator WEICKER. That is very unfair. I just did my 100 laps in the pool, and I am down to 299.

The CHAIRMAN. Everyone who believes that, stand on your head.

Senator KASTEN. I would like to make, Mr. Chairman, a brief statement.

STATEMENT OF HON. ROBERT W. KASTEN, JR., A U.S. SENATOR FROM THE STATE OF WISCONSIN

Senator KASTEN. I would like to welcome Administrator Abdnor as he presents the Administration's budget request for fiscal year 1989. In most respects this proposal mirrors the one that was sent up last year. The loan sales, transfer of the MBDA from Commerce, and proposals concerning loan cutbacks are familiar to the Committee. But we do have several proposals before this Committee dealing with the 8(a) reform and the COSBI legislation that would also require that we work closely with the SBA in the coming year. I know that the Administration has mixed feelings about certain aspects of these congressional initiatives, and I look forward to working with Jim and the Committee as we forge the programs that will most benefit the small business community while recognizing the constraints of the Budget Summit of last year and Gramm-Rudman-Hollings.

But more importantly, Jim, I would like to congratulate you on your initiatives, particularly in energy, and note the fact that tomorrow is going to be your 1 year anniversary, I am told. One year from tomorrow you will have been at the helm of this agency for 1 year, and I congratulate you for 1 full year less 1 day of your tenure, and look forward to continuing to be working with you.

Mr. Chairman, I ask that this statement appear in the regular order, after your statement and the other opening statements.

The CHAIRMAN. So ordered.

Senator Weicker, do you have an opening statement?

Senator WEICKER. I have an opening statement. I ask unanimous consent it be placed in the record.

The CHAIRMAN. Without objection.

[The prepared statement of Senator Weicker follows:]

OPENING STATEMENT OF SENATOR LOWELL WEICKER, JR.

HEARING ON SMALL BUSINESS ADMINISTRATION'S FY 1989 BUDGET

MARCH 22, 1988

MR. CHAIRMAN, IT IS A PLEASURE TO PARTICIPATE IN THIS HEARING ON THE SMALL BUSINESS ADMINISTRATION'S (SBA) BUDGET REQUEST FOR FISCAL YEAR 1989. THE THREE-YEAR BUDGET AGREEMENT THAT WAS NEGOTIATED WITH THE ADMINISTRATION EXPIRES ON SEPTEMBER 30TH OF THIS YEAR. SO THE COMMITTEE WILL NEED TO ACT AND ESTABLISH A BUDGETARY BLUEPRINT FOR THE AGENCY.

AT THE OUTSET, I WOULD LIKE TO COMMEND ADMINISTRATOR JIM ABDNOR FOR THE LEADERSHIP AND DIRECTION HE HAS PROVIDED THIS AGENCY OVER THE LAST YEAR. JIM HAS DONE MUCH TO RESTORE THE MORALE OF THE SBA EMPLOYEES AND GIVE THEM A SENSE OF STABILITY AND PURPOSE. AS HIS TESTIMONY INDICATES, JIM HAS AGGRESSIVELY SOUGHT TO PUT SBA BACK ON THE MAP. HIS INITIATIVES IN RURAL DEVELOPMENT, INTERNATIONAL TRADE, AND YOUNG ENTREPRENEURS ARE TESTIMONY TO HIS DEDICATION TO THE AGENCY'S MISSION.

WITH RESPECT TO THE BUDGET SUBMISSION, I AM PLEASED THAT SBA'S FIELD STRUCTURE WILL REMAIN LARGELY IN TACT, AT A STAFFING LEVEL OF 4300 FULL-TIME EMPLOYEES. FURTHERMORE, THE 7(A) GUARANTEED LOAN PROGRAM, THE SBIC AND THE SECTION 503 CERTIFIED LOAN PROGRAMS ARE FULLY FUNDED. HOWEVER, THERE ARE SEVERAL ASPECTS OF THE BUDGET THAT CAUSE ME GREAT CONCERN.

FIRST, THE ADMINISTRATION WOULD FUNDAMENTALLY ALTER THE METHOD OF FUNDING OF THE MESBIC PROGRAM. IF ENACTED, THIS IMPORTANT PROGRAM WHICH PROVIDES EQUITY AND DEBT CAPITAL TO MINORITY BUSINESSES WOULD BE SEVERELY UNDERMINED. SECOND, THE BUDGET CALLS FOR A SIGNIFICANT REDUCTION AND ULTIMATE PHASE OUT OF FEDERAL FUNDING FOR THE SMALL BUSINESS DEVELOPMENT CENTER (SBDC) PROGRAM. A REDUCTION OF $40 MILLION TO $26 MILLION IS RECOMMENDED FOR FY 1989. SBDC'S ARE NOW IN OVER 40 STATES PROVIDING LOW COST MANAGEMENT ASSISTANCE AND COUNSELING TO SMALL BUSINESSES. THE FEDERAL DOLLARS ARE MATCHED, AND OFTEN EXCLUDED, BY STATE AND PRIVATE SECTOR RESOURCES. HOWEVER, A FEDERAL/LOCAL PARTNERSHIP MUST BE MAINTAINED FOR THIS PROGRAM TO CONTINUE.

THIRD, ALL TARGETED LOANS FOR MINORITIES, HANDICAPPED AND VIETNAM VETERANS ARE ELIMINATED. FOR THESE GROUPS, DEBT CAPITAL IS SIMPLY NOT AVAILABLE THROUGH COMMERCIAL LENDERS. I AGREED WITH THE ADMINISTRATION'S EFFORTS TO ELIMINATE MOST OF SBA'S DIRECT LENDING. HOWEVER, I BELIEVE SBA MUST PLAY THE ROLE OF LENDER OF LAST RESORT IN THESE NARROWLY DEFINED CIRCUMSTANCES.

FINALLY, THE ADMINISTRATION ONCE AGAIN CALLS FOR A $1 BILLION OF SBA BUSINESS AND DISASTER LOANS TO BE SOLD IN FY 1989. SENATOR BUMPERS AND I INCLUDED LANGUAGE IN LAST YEAR'S APPROPRIATION PROHIBITING SUCH AN ASSET SALE. I WILL CONTINUE TO OPPOSE THIS INITIATIVE FOR TWO REASONS. FIRST, I BELIEVE THE TAXPAYER WILL BENEFIT MORE BY ALLOWING SBA TO MANAGE THE LOAN PORTFOLIO. THE AGENCY'S DEBT COLLECTION EFFORT HAS GREATLY IMPROVED. THE

GOVERNMENT WILL GET A RETURN OF AT LEAST 90 CENTS ON A DOLLAR IF YOU LET SBA SIMPLY DO ITS JOB. ANY SALE OF LOANS, WITHOUT RECOURSE, WILL BE DISCOUNTED. SECOND, ASSET SALES IS AN EXAMPLE OF "SMOKE AND MIRRORS" BUDGETING. AS ALAN GREENSPAN OF THE FEDERAL RESERVE RECENTLY STATED BEFORE THE BUDGET COMMITTEE: "BUT I WOULD STRESS THAT THE RESULTING ASSET SALES SHOULD NOT OBSCURE THE MORE FUNDAMENTAL BUDGETARY ISSUE. INDEED, I WOULD BE TROUBLED BY THE EXTENSIVE USE OF ASSET SALES AS A LONG-RUN DEFICIT-REDUCTION STRATEGY. MERELY SHIFTING OWNERSHIP OF AN ASSET FROM THE FEDERAL GOVERNMENT TO THE PRIVATE SECTOR HAS LITTLE EFFECT ON OVERALL CREDIT DEMAND; MOREOVER, IT PRODUCES ONLY A ONE-TIME BUDGET SAVING".

MR. CHAIRMAN, THE GOOD NEWS IS SBA IS ALIVE AND OPERATING UNDER STRONG LEADERSHIP. THE BAD NEWS IS SEVERAL ESSENTIAL PROGRAMS CONTINUE TO BE UNDER ATTACK BY OMB. CONGRESS WILL NEED TO STEP IN AND CONTINUE TO PROTECT THESE VITALLY IMPORTANT LENDING AND MANAGEMENT ASSISTANCE PROGRAMS. I LOOK FORWARD TO WORKING WITH SENATOR BUMPERS IN FASHIONING AN FY 1989 AUTHORIZATION FOR THIS IMPORTANT AGENCY.

MARCH 22, 1988

STATEMENT BY SENATOR ALAN J. DIXON

COMMITTEE ON SMALL BUSINESS

HEARING ON THE FY 1989 BUDGET
REQUEST FOR THE SBA

THANK YOU, MR. CHAIRMAN.

THE ADMINISTRATION'S FISCAL YEAR 1989 BUDGET PROPOSAL FOR THE SMALL BUSINESS ADMINISTRATION BEARS A STRIKING RESEMBLANCE TO LAST YEAR'S. ONCE AGAIN WE SEE ELIMINATION OF DIRECT LOANS, A DECREASE IN THE PROPORTION OF GUARANTEED LOANS SUPPORTED BY THE SBA, AND SUBSTANTIAL LOAN PORTFOLIO SALES. IT APPEARS THAT THE ONLY REAL MAJOR DIFFERENCE BETWEEN LAST YEAR AND THIS IS THE LEVEL OF OPTIMISM.

FOR EXAMPLE, VIRTUALLY ALL ASSET SALES PROPOSED BY THE ADMINISTRATION YIELD A HIGHER RETURN THAN LAST ANTICIPATED. ABSENT SUBSTANTIAL INTEREST RATE CHANGES IT IS NOT CLEAR WHY THERE WOULD BE SUCH A DRAMATIC DIFFERENCE IN RETURNS.

MANY OF THE PROPOSED CHANGES IN ORGANIZATION AND FUNDING LEVELS CONTAINED IN THE ADMINISTRATION'S PACKAGE WERE SPECIFICALLY REJECTED LAST YEAR BY THIS COMMITTEE. I HOPE THAT TESTIMONY WE RECEIVE TODAY SHEDS LIGHT ON THE CIRCUMSTANCES WHICH CHANGED FROM LAST YEAR, AND WOULD LEAD US TO BE MORE UNDERSTANDING OF THE ADMINISTRATION'S BUDGET PROPOSAL. I AM NOT OPTIMISTIC, BUT I AM WILLING TO EXAMINE THE ISSUES AGAIN.

STATEMENT OF SENATOR JIM SASSER

SMALL BUSINESS ADMINISTRATION'S FY 1989 BUDGET REQUEST

SENATE SMALL BUSINESS COMMITTEE

MARCH 22, 1988

MR. SASSER: MR. CHAIRMAN, AS I REVIEWED THE SMALL BUSINESS ADMINISTRATION'S PROPOSED BUDGET FOR THE UPCOMING YEAR, I WAS VERY TROUBLED. AS THE CHAIRMAN WELL KNOWS, MANY OF US ON THIS COMMITTEE HAVE WORKED LONG AND HARD TO PROMOTE GREATER PARTICIPATION BY SMALL BUSINESS IN OUR EXPORT MARKETS. I FEAR THAT THIS BUDGET REQUEST COULD WELL ERASE MUCH OF OUR EFFORTS.

LEGISLATION I INTRODUCED LAST YEAR SERVED AS THE VEHICLE FOR THE SMALL BUSINESS TITLE OF THE TRADE BILL. WE RECENTLY COMPLETED CONFERENCE ACTION ON THAT TITLE. AS A RESULT WE ARE MOVING CLOSER TO ACHIEVING OUR GOAL OF HELPING SMALL BUSINESS PLAY A GREATER ROLE IN THE WORLD OF INTERNATIONAL TRADE.

I WAS ENCOURAGED NOT ONLY BY THE PROGRESS WE WERE MAKING ON THE TRADE BILL, BUT BY INDICATIONS THAT OUR MESSAGE WAS GETTING THROUGH. SMALL FIRMS WHICH WERE HERETOFORE RELUCTANT TO COMPETE OVERSEAS WERE TAKING THE FIRST TENTATIVE STEPS TO BECOME A PLAYER IN TODAY'S WORLD MARKET. A RECENT ISSUE OF BUSINESS WEEK

PROCLAIMED THAT THE MUCH OF THE RECENT UPSURGE IN UNITED STATES EXPORTS WAS ATTRIBUTABLE TO SMALL BUSINESS. ONE OF THE LEAD STORIES IN THIS ISSUE EXPLORED WHY LITTLE COMPANIES ARE LEADING THE EXPORT BOOM.

AMID THESE HOPEFUL SIGNS WE SEE A BUDGET REQUEST WHICH SUGGESTS THAT THE SMALL BUSINESS ADMINISTRATION IS PUTTING THE BRAKES ON EFFORTS TO EXPAND SMALL BUSINESS PARTICIPATION IN EXPORT MARKETS. THE ADMINISTRATION PROPOSES PHASING OUT THE SMALL BUSINESS DEVELOPMENT CENTER PROGRAM. YET, OUR TRADE BILL MAKES SBDC'S THE LEAD PLAYER IN DELIVERING CRUCIAL EXPORT ADVICE AND SERVICES TO SMALL BUSINESS. I SEE NO REQUEST FOR THE $5 MILLION WE ARE AUTHORIZING FOR A VARIETY OF SMALL BUSINESS EXPORT PROGRAMS IN THE TRADE BILL. I DO SEE PROPOSED USER FEES ON A NUMBER OF SERVICES THAT A FIRM MIGHT USE IN EXPLORING EXPORT OPPORTUNITIES AND I CAN ONLY SPECULATE THAT SUCH USER FEES WILL SERVE AS A DETERRENT AMERICAN FIRMS COMPETING ABROAD.

GIVEN THE PROGRESS WE HAVE BEGUN TO MAKE, WE OUGHT NOT TO SHIFT INTO NEUTRAL, MR. CHAIRMAN. AND THAT'S WHAT THIS BUDGET PROPOSAL DOES TO OUR EFFORTS TO BRING SMALL BUSINESS INTO THE WORLD OF EXPORTING. WE SIMPLY CANNOT AFFORD TO SIT IN IDLE IF WE HOPE TO BECOME TRULLY COMPETITIVE IN WORLD MARKETS. I INTEND TO CONTINUE TO MOVE FORWARD ON MAKING SMALL BUSINESS A GREATER PLAYER IN EXPORT MARKETS AND WOULD HOPE THE AMDINISTRATION WOULD WORK WITH US TOWARDS THAT END.

STATEMENT BY SENATOR ALFONSE M. D'AMATO
BEFORE THE SMALL BUSINESS COMMITTEE
PRESIDENT'S FY 1989 BUDGET FOR SBA
MARCH 22, 1988

MR. CHAIRMAN, I WOULD LIKE TO WELCOME TO THE SMALL BUSINESS COMMITTEE THIS AFTERNOON THE WITNESSES WHO WILL PRESENT THEIR VIEWS ON THE PRESIDENT'S PROPOSED FISCAL YEAR 1989 BUDGET FOR THE SMALL BUSINESS ADMINISTRATION.

THE PRESIDENT'S FISCAL YEAR 1989 BUDGET IS VERY SIMILAR TO LAST YEAR'S PROPOSAL. ONCE AGAIN, THE ADMINISTRATION HAS PROPOSED TO MOVE THE MINORITY BUSINESS DEVELOPMENT AGENCY OUT OF THE DEPARTMENT OF COMMERCE AND OVER TO THE SBA. THIS WOULD BE A GRAVE MISTAKE. THE PURPOSE OF THE MBDA IS TO FOSTER MINORITY BUSINESS DEVELOPMENT. MBDA'S SERVICES DIFFER FROM THOSE OFFERED THROUGH THE SBA. THE NEEDS OF MINORITY BUSINESS REQUIRE AN INDEPENDENT AGENCY COMMITTED TO FOCUSING ON THE UNIQUE CIRCUMSTANCES OF MINORITY BUSINESSES.

OTHER ITEMS IN THE FY 1989 BUDGET INCLUDE THE SALE OF MOST SBA LOAN ASSETS, THE CREATION OF OR INCREASE IN USER FEES ON MANY PROGRAMS, THE ELIMINATION OF ALL DIRECT LOAN

PROGRAMS, AS WELL AS A DECREASE IN THE GUARANTEED AMOUNT OF REGULAR BUSINESS LOANS.

THE VERY REASON FOR THE EXISTENCE OF THE SBA IS TO ENCOURAGE AMERICANS GIFTED WITH ENTREPRENEURIAL SKILLS TO MAKE WORTHWHILE CONTRIBUTIONS TO THE BUSINESS WORLD. THESE ARE THE VERY PEOPLE WHO WILL KEEP THE U.S. COMPETITIVE IN THE WORLD MARKETPLACE. WE MUST CAREFULLY ASSESS THE IMPACT THAT THE PROPOSED FY 1989 BUDGET WILL HAVE UPON THESE PEOPLE WHO ARE ESSENTIAL TO THE CONTINUED COMPETITIVENESS OF OUR NATION.

I LOOK FORWARD TO THE TESTIMONY OF OUR WITNESS THIS AFTERNOON AND TO THEIR VIEWS ON THE ADMINISTRATION'S PROPOSED FY 1989 BUDGET FOR THE SBA.

THANK YOU, MR. CHAIRMAN.

The CHAIRMAN. Senator Abdnor, let me ask you about the proposed elimination of direct loans to veterans and handicapped and the MESBICs, and so on.

Let's take handicapped first. Now, admittedly, let's see, in 1988 they are getting $14 million. The veterans are getting $18 million, and the MESBICs $36 million. But let's take handicapped.

Now, they get a 3 percent interest rate, which is obviously a highly subsidized rate, but let me ask you first of all, were those funds not sought last year?

Senator ABDNOR. Were they what?

The CHAIRMAN. Were they not sought-after pretty competitively last year among the handicapped?

Senator ABDNOR. Yes, they were. And if I could call on Mr. Rosenbaum, what was the full amount used?

Mr. ROSENBAUM. Mr. Chairman, in 1987 we approved $9.8 million in handicapped funds. We did not approve all the funds that were available to the agency that year.

The CHAIRMAN. The full $14 million?

Mr. ROSENBAUM. Not for 1987. We only approved a little less than $10 million of the $14 million we had available during 1987.

The CHAIRMAN. What was the total dollar amount of all the applications you received?

Mr. ROSENBAUM. We do not have the application value here. We know that in terms of the total loans approved, we made the money available to the regions and district offices.

In terms of how many applications, that is held by our regional and district offices, and we do not keep that available.

The CHAIRMAN. My concerns about all three of those programs are that, while I understand the argument the Administration is making on this, this funding is not nearly enough, in my opinion. The participating banks are not going to cover 10, 15, 25 percent or 20 percent of the risk for loans for handicapped people, for example, and I think what you are saying is we are just not going to make any loans to handicapped, and let them go the best way they can.

And quite frankly, this fund has just been cut so dramatically over the last 7 years, I do not think this Committee is going to let that fund be totally eliminated, and I do not buy the argument that they are quite capable of getting this money in the private sector. Handicapped people obviously are not as good a loan applicant as perfectly healthy people are, and we are giving them a very small amount of money, and a subsidized interest rate on that small amount of money, to try to help them become self-sufficient.

What is your default rate on handicapped loans?

Mr. ROSENBAUM. Generally speaking, it is about the same as on our other lending programs.

The CHAIRMAN. You mean guaranteed loans?

Mr. ROSENBAUM. On our other direct lending programs.

The CHAIRMAN. Do you know what that figure is?

Mr. ROSENBAUM. Yes. On direct loans it runs about 15 percent as an actual loss rate.

The CHAIRMAN. So that is what the veterans' loss rate is also, about 15 percent?

Mr. ROSENBAUM. Yes, sir.

I can break down for the record our loss rate by program, if necessary.

[Material follows:]

PROGRAM	ACTUAL LOSS RATE 1987	ACTUAL LOSS RATE 1986	ULTIMATE LOSS RATE 1987	ULTIMATE LOSS RATE 1986
BUSINESS				
DIRECT	16.25%	14.57%	19.45%	17.58%
IMMED. PART	4.05%	3.81%	4.18%	3.93%
GUARANTY	7.47%	6.96%	12.39%	13.27%
PROGRAM AVERAGE	7.90%	7.35%	12.45%	13.07%
ECONOMIC OPPORTUNITY LOANS				
DIRECT	32.75%	32.07%	37.46%	37.49%
IMMED. PART	11.62%	10.31%	12.04%	10.87%
GUARANTY	17.94%	18.39%	24.23%	27.23%
PROGRAM AVERAGE	26.90%	26.79%	32.18%	33.45%
DEVELOPMENT COMPANY LOANS				
DIRECT	11.05%	10.14%	12.85%	11.87%
IMMED. PART	4.38%	4.05%	4.65%	4.30%
GUARANTY	1.16%	1.49%	3.33%	6.22%
PROGRAM AVERAGE	3.89%	4.68%	5.85%	8.01%
HANDICAPPED LOANS				
DIRECT	11.12%	10.45%	16.65%	16.09%
IMMED. PART	3.13%	3.17%	4.61%	4.45%
GUARANTY	6.11%	3.61%	10.01%	8.31%
PROGRAM AVERAGE	10.41%	9.69%	15.64%	15.03%
ENERGY LOANS				
DIRECT	37.25%	31.25%	62.24%	34.98%
IMMED. PART	56.61%	48.60%	60.94%	52.81%
GUARANTY	21.63%	21.24%	33.74%	30.28%
PROGRAM AVERAGE	30.97%	27.32%	50.12%	33.31%

PROGRAM	ACTUAL LOSS RATE		ULTIMATE LOSS RATE	
	1987	1986	1987	1986
DISPLACED BUSINESS LOANS				
DIRECT	5.28%	4.66%	6.25%	5.52%
IMMED. PART	0.86%	0.86%	0.98%	0.98%
GUARANTY	14.83%	13.13%	14.83%	13.22%
PROGRAM AVERAGE	4.66%	4.15%	5.49%	4.87%
DISASTER LOANS				
DIRECT	7.56%	6.21%	10.00%	7.62%
IMMED. PART	11.18%	10.16%	12.44%	11.33%
GUARANTY	3.51%	3.47%	25.98%	15.46%
PROGRAM AVERAGE	7.58%	6.24%	10.08%	7.68%
ALL AGENCY PROGRAMS	8.18%	7.54%	12.15%	12.12%

The CHAIRMAN. You have said that with respect to your MESBIC proposal, that the MESBIC's need could be accommodated out of existing SBIC guarantee authority, but you did not provide for an increase in SBIC authority to accommodate MESBIC's $36 million level of activity.

So is this not really a significant reduction in assistance going to minority-owned businesses?

Mr. ROSENBAUM. We did provide for a switch in the funding from a direct MESBIC to the guaranteed level. What we did in our proposal was to reduce the amount of guarantees for the regular SBICs which have been underutilized in the last several years. We brought that request back to a more realistic level of about $150 million.

In addition to that, we added another $36 million for MESBICs to come to our total request of $186 million which would be used for both SBICs and MESBICs.

The CHAIRMAN. Is there any requirement that SBICs make any percentage of loans to either handicapped or minorities under existing law?

Mr. HOLLOWAY. No, Mr. Chairman, there are not.

The CHAIRMAN. Under the asset sales, you have got a much bigger return figure here.

Now, you say Paine Webber now says that we can recover 70 to 75 percent. I think that was the figure, was it not?

Mr. ROSENBAUM. That is right, depending on the program, it ranges from as high as 75 percent down to 58 percent.

The CHAIRMAN. That is a significantly higher figure than anything we have ever heard in a hearing here.

Has Paine Webber always done these studies for us?

Mr. ROSENBAUM. Not for this agency.

The CHAIRMAN. Is this their first one?

Mr. ROSENBAUM. For our agency, yes, sir.

The CHAIRMAN. You have all heard testimony in this Committee on at least two or three occasions in the last several years by some people on Wall Street estimating a return of about 30 cents to 45 cents on the dollar if these portfolios were sold without recourse.

Now all of a sudden we have this significantly higher projection of what we would get for the sales of these assets. We might as well just lay it on the table. I do not want to belabor it. We aren't going to sell these assets anyway. This Committee has said time and time again we are not going to do it.

I do not want to get into it, but I am just curious as to how this Paine Webber figure all of a sudden is much higher than anything we have ever heard in this Committee.

Do you have their study?

Mr. MOFFITT. Yes, Senator, we have a copy of it.

The CHAIRMAN. We will talk about it later on.

Mr. MOFFITT. What you have is a copy of the executive summary. We will also provide you with a copy of their full study.[1]

The CHAIRMAN. All right.

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[1] Material retained in Committee files.

Senator WEICKER. In other words, what we are saying is "No thanks, Paine Webber."

The CHAIRMAN. Shearson or somebody ought to make a commercial out of that.

And user fees—again, of course, we are not going to increase user fees either. The Administration never seems to learn that we aren't going to do this.

But I was curious on these user fees, on surety bonds, an increased fee from $6 per thousand to $8 per thousand, how much money does that produce?

Mr. ROSENBAUM. We estimate that the two proposals in Surity Bond would increase revenues by about $4½ million.

The CHAIRMAN. That would produce $4½ million?

Mr. ROSENBAUM. Yes, sir, Mr. Chairman.

The CHAIRMAN. In the 504 Development Program, you have a very high rate, currency rate, 95, 96 percent, which is a very minuscule loss rate. Why do we want to increase the existing 1½ percent guarantee rate.

Let's see, what are you raising that to, incidentally? It is 1½ percent now, is it not?

Oh, you are asking for an additional 1½ percent to the existing 1½ percent, is that correct?

Mr. MOFFITT. That is correct.

The CHAIRMAN. No. 1, how do you justify that number, and No. 2, how much money would that produce?

Mr. MOFFITT. Approximately $6.2 million.

The CHAIRMAN. That is what you are getting now, and you would increase it by that amount?

Mr. MOFFITT. That is correct.

The CHAIRMAN. Are you proposing to drop the guarantee rates, too, on the guaranteed loan programs from 90—what is it right now, 90 percent, up to $155,000?

Mr. MOFFITT. That is correct.

The CHAIRMAN. Eighty-five percent on over $155,000.

Mr. MOFFITT. That is correct.

The CHAIRMAN. Have you proposed to change that this year?

Mr. ROSENBAUM. Yes, sir.

The CHAIRMAN. Down to what, 75 percent?

Mr. ROSENBAUM. We will phase it down over the next five years to a 75 percent Government exposure for those loans in excess of $75,000.

The CHAIRMAN. What you people cannot do with a broad axe you are trying to do here surreptitiously over a long period of time.

Well, let's see, how about staffing? Are you asking for any additional money for staffing?

Mr. ROSENBAUM. With the exception of the pay raise and the annualization of the current staffing, no, sir. Obviously there is the transfer of the staffing from MBDA coming over to us in our proposal.

The CHAIRMAN. You are asking for 25 additional employees to enforce the 8(a) Program, is that correct?

Senator ABDNOR. In this year, we have already increased the staff.

Mr. ROSENBAUM. We increased the staff by 10 additional people in the central office. That was a 25 percent increase over the previous central office staffing level. This was done in response to the problems that we saw with the program.

The CHAIRMAN. I just assumed that that was a 25-percent increase in the central office, is that not correct?

Mr. ROSENBAUM. That is correct. That is from the 10 new positions we added.

The CHAIRMAN. That 25 percent would be 10 new positions in that program?

Mr. ROSENBAUM. Yes, sir, Mr. Chairman.

The CHAIRMAN. Incidentally, I assumed that SBA applauds what we are trying to do in this committee with that program by tightening it up.

Senator ABDNOR. Yes, we certainly do.

The CHAIRMAN. The other question I wanted to ask you is, for the last 2 or 3 years, in proposing to transfer the MBDA Program to SBA, we still have not been provided with any kind of an implementation plan on that by SBA.

Mr. MOFFITT. Senator, we will have that plan to you very shortly.

The CHAIRMAN. You know, you are not the first person to ever say that.

Mr. MOFFITT. But I do not think that I have ever told you that we would have it to you shortly, and we will.

The CHAIRMAN. OK, Mr. Moffitt, I am going to remember your name and this date and see if we get one.

You get 270 new positions if we transfer this to SBA, is that right?

Mr. ROSENBAUM. It is 242 new full-time equivalent positions. And this would be the total contingent over at MBDA right now, and that is different from last year's proposal.

The CHAIRMAN. Are you going to use a big chunk of those to shore up the 8(a) Program?

Mr. MOFFITT. Well, we do not anticipate that.

The CHAIRMAN. You do not plan to use those for——

Mr. MOFFITT. We do not anticipate any significant transfer from the functions they are performing now, depending on how we would structure and implement the combined programs. Any increase in the 8(a) Program would come from within the existing agency ceiling.

Senator ABDNOR. But strengthening their function will make the 8(a) Program better. We hope with their assistance we can give more guidance.

The CHAIRMAN. If you were just a detached observer and you heard Jim Miller and Alan Greenspan debating the sale of these assets—I guess Jim Miller would love to take the chandeliers out of this office, this room, and sell them. He would like to sell off the Government. Alan Greenspan, I thought, made a very responsible statement the other day. If Alan Greenspan, who is the guy we depend on to walk the tightrope and keep our economy afloat and interest rates at a reasonable level and the growth rate going so we can balance the budget, why would the Administration want to fly right into the face of everything he believes about selling off assets?

Mr. MOFFITT. If that were the only reason to sell off assets, I do not think the Administration would oppose what he was saying. Keep in mind that the asset sale initiative, which potentially would affect not only SBA but other Government credit agencies, is part of deficit reduction. Deficit reduction was considered as one benefit of asset sales, but perhaps the least one. Other benefits were the improved credit management, the administrative savings that would accrue to an agency that was able to sell their assets, and a way of determining the subsidy inherent in the loan.

So the purpose of asset sales was not exclusively to reduce the deficit.

The CHAIRMAN. Well, as I say, I do not think it is going to happen anyway.

Let me also say in parting, Jim, that I feel the relationship between Congress, especially this Committee, and SBA, has improved a lot since you took over. We do not always agree, and you cannot always accede to everything we want, but I do think that as a former Member of this body, you have a keen appreciation for our concerns, and you have tried to meet them as best you could within the constraints put on you, and we are very pleased with your service over there.

Senator ABDNOR. Well, thank you.

The CHAIRMAN. Senator Weicker.

Senator WEICKER. Let me give you one suggestion, Jim, because you and I worked long and hard on these matters in the past. Do not ever let anybody in OMB or your staff hoodwink you into coming up to the Hill, when you know that Senator Weicker is going to be on the other side of the table, and advocate an elimination of programs for the handicapped. I think somebody did a number on you, I really do. You are just lucky you and I are friends. Otherwise I would take this budget proposal, and I would not question it, I would throw it at you.

On such things as the sale of assets, and in terms of the handicapped, the economic opportunity, and the veterans' loans programs. I think we can just all forget what is being proposed in this budget. I will tell you why I feel so strongly about it; I have a feeling that so many of the small business constituencies do not support the Small Business Administration with the enthusiasm they should because those small business constituencies have all made it.

I was aghast when a member of the Administration tried to eliminate SBA, that I was not getting this overwhelming support from the NFIB and all these various other groups. The reason why I did not get too excited when they came down on my head was because they were the guys who worked with Reagan to eliminate the Small Business Administration.

But I realized that probably the reason why they are not enthusiastic about SBA is that they are just trying to hold on to what they have; whereas the purpose of the Small Business Administration is to be there when somebody who wants to get into the economic mainstream cannot do so by virtue of the normal channels of banks, insurance companies or whatever.

And so, when I see veterans' loans and handicapped loans and economic opportunity loans at risk, there is no way I am going to go ahead and buy that.

I want to make it clear that to me they come closer to your real mission than anything else that you do.

I do want to ask a couple of questions.

The SBDC Program. Everywhere I go, I hear nothing but the greatest enthusiasm for this program. We have a program at the University of Connecticut and at the University of New Haven. So, I am just wondering why the Small Business Development Program does not have Administration support. I would think that it would be almost in line with the Reagan philosophy of trying to decentralize and get things going at the local level.

Senator ABDNOR. What was the question?

Senator WEICKER. The question is why do you want to go ahead and eliminate it when it is such an overwhelming success?

Senator ABDNOR. I do not think the intent is to eliminate it. I guess the thought is something like our 8(a) Program. In time you would graduate the SBDCs and expect them to be able to go out on their own and continues working with the States and the other organizations. Getting them started is one thing, but perpetuating them for a long period of time, we did not think was the intent of the program. Our proposal is a gradual phaseout. It is not just shutting off the funding immediately.

Senator WEICKER. Well, it just started.

Senator ABDNOR. Well, some of them——

Senator WEICKER. It just started, and the problem right now, to give you an example——

Senator ABDNOR. Our proposal is not going to discontinue the funding of the new SBDCs starting up. We will fund those and gradually phaseout the program in 5 years?

Mr. ROSENBAUM. It is a 5-year phaseout.

Senator WEICKER. Five-year phaseout, but what I am saying to you is that it comes at a time when most State budgets are now turning around. There was a time, as recent as a year ago when the State budgets for the last 5 or 6 years have been running big surpluses, and they would take over something like this, maybe. Not now, not now. I can tell you right now, if the Federal Government gets out of this, the State of Connecticut is not going to go ahead and fund it.

I think we have just started. How many years have the SBDCs been actually in operation? Since 1977. So you are talking 10 years. It seems to me that there might come a time when there might be an enthusiasm shown by the various universities and colleges that really are the mainstay of the program, but to go ahead and fund it at the local and State level, I do not see that yet.

Senator ABDNOR. I was going to have Mr. Rosenbaum make a comment.

Mr. ROSENBAUM. Senator Weicker, in reviewing the enabling legislation back in 1976–77, it was really never intended at that time to have Federal funding of this program in perpetuity. Its intention was to have Federal funding to come in, start the SBDCs, get them going, and they have the SBDCs through their matching process

get funding from States and other organizations within the university system, and then the Federal funding would be phased out.

Senator WEICKER. And you think they would pick this up?

Have you written to the States and asked them?

Mr. ROSENBAUM. Well, right now we do have a very good response from a lot of the States who are funding in excess of their one-to-one match. Currently, the match is about $1.50 to a dollar of Federal funding. So they are funding in excess of what they are legally required to fund.

So there are many States—I am not sure about your State, Senator, but there are States who are participating way in excess of the program requirements.

Senator WEICKER. Well, again, I look upon the Small Business Administration as giving an opportunity to people, not those that have made it but those that want to make it, and I think this is again another program that contributes to that end.

The last question, and the rest I will submit for the record. The Administration's budget justification recognizes that, "the major incentive for the formation of MESBICs is the availability of subsidized leverage" in the form of preferred stock, which is the form that leverage would take. Yet, the Administration's budget proposal to eliminate all direct funding for the MESBIC Program recommends that MESBICs obtain funding on the same terms as regular SBICs.

Do you believe that more MESBICs will be formed to provide minority businesses with long-term debt and equity financing if the preferred stock is eliminated, and do you think there is a need for a long-term debt and equity financing for minority businesses?

Mr. HOLLOWAY. Mr. Chairman, I guess in broad theory, we are just saying that we think we can do the job with the guarantee program rather than with the direct program. We will have 100 percent guarantees for these MESBICs, and we believe that funding will be available to them.

It is true that they will not have the amount of subsidy they presently have, and that I suppose is a matter of the priorities of things. Where do you take reductions when you are trying to cut back?

A look at the statistics in the operation of the present program shows us that in any event, the reason for these subsidies was primarily so that management assistance could be provided and so that a lower rate could be passed on to the small business concerns, and so that more equity financing could be made. In a review of all those issues, we find that as far as equity money is concerned, only about 14 percent of the money is going into equity money anyway, and so about 85 percent of it is going into loans and debt securities.

As far as the management assistance area is concerned, in a recent survey, only about 2 percent of them answered yes, that they were providing management assistance; 84 percent said they were not providing management assistance; and 14 percent did not answer the question.

So on balance, we believe that the proposal to fund the MESBICs with 100 percent guarantees will make ample funding available to them, and that they can get the job done and loan money as cheap-

ly as they are loaning it now, which is comparable to what the SBICs are charging without the subsidy.

Senator WEICKER. I have no further questions, Mr. Chairman.

Senator PRESSLER. Mr. Chairman, I have just a comment. I apologize for being late. I have been at another Committee meeting, and I have another one to go to, believe it or not.

STATEMENT OF HON. LARRY PRESSLER, U.S. SENATOR FROM THE STATE OF SOUTH DAKOTA

Senator PRESSLER. I wish to welcome back my good friend and longtime colleague, Jim Abdnor. It is good to see you.

Senator ABDNOR. Thank you.

Senator PRESSLER. And I know that you have done a lot of work on developing international trade for small businesses and helping to coordinate Federal programs to assist rural economic development, two things that are dear to my heart and our State of South Dakota. I have just been working with one of the companies in my State to export more Black Hills gold to Europe, not necessarily through an SBA program, but it is a small business doing it.

So I guess increasingly we are getting into international trade, and I commend you and your agency for digging into it.

I shall be looking closely at the budget, along with others here as we go through the year, and I suspect there will be some changes made, as always, but my principal concern is that we continue to lend all possible support to the Nation's small businesses within existing budget constraints. I thank you, Mr. Chairman.

Senator ABDNOR. Mr. Chairman, before we conclude——

Senator WEICKER. One minute, Jim.

I think the Chairman has a question. I have to leave, but I did say that I would stay here for this question because I think it is terribly important.

The CHAIRMAN. Jim, I received this from a group of people in California that are concerned about this Senator Campbell's Conference on Women.

Are you familiar with that, a conference held by a California State Senator?

Senator ABDNOR. I have just heard about it. I do not know the specifics of it.

The CHAIRMAN. I have to confess to you, this brochure looks to me like a "Senator Campbell for King" program more than a conference for women. The whole thing features Senator Campbell most prominently. "Senator Campbell's Conference on Women," I want you to look at this, in bold print, and down here, as co-sponsor, and I have to put my glasses on to see this, is the U.S. Small Business Administration, and Chrysler Credit Corp., Plymouth Division. Now, it says, "6th annual, dynamic, 3-day conference." If that says, "Senator Campbell's Conference on Women once, it must say it 40 times in this brochure. And now this particular one is sent out on the SBA frank. And let me say this, he has got some top drawer-people. Certainly the quality of people he is bringing to this conference, many of them are really top-drawer and can make a contribution, and he has got a long list of corporate patrons here.

Have you seen this brochure, Jim?

Senator ABDNOR. No, I have not.

The CHAIRMAN. Have you, Mr. Moffitt?

Mr. MOFFITT. I am familiar with it, yes.

Senator WEICKER. Well, how do you respond? That is outrageous.

The CHAIRMAN. Here is another brochure that he has sent out, again, Just Senator Campbell's Conference on Women. This one is sent out over the Small Business frank, over SBA's frank.

I would like to know how many thousand went out, what they cost, and how we are cosponsoring that.

Mr. MOFFITT. This is, as you pointed out, the 6th time this was done. The fact that the brochure featured Senator Campbell very heavily and prominently came to our attention just recently.

The total cost for franking and printing was approximately $60,000.

The CHAIRMAN. How much?

Senator WEICKER. $60,000?

Mr. MOFFITT. That is correct, $60,000.

The CHAIRMAN. That is what this conference cost SBA?

Mr. MOFFITT. That is correct.

Senator WEICKER. The mailer? How much did the mailer cost?

The CHAIRMAN. The mailer cost $60,000?

Mr. MOFFITT. Yes, for franking and printing.

The CHAIRMAN. Is this the total cost of SBA for the frank?

Mr. ROSENBAUM. No, about $22,000 is for the printing, and the balance is for the postage.

Mr. MOFFITT. It is a combination of the two, the total is $60,000.

We have instructed the regions that in the future, those individuals who cosponsor with us should not be so prominently displayed. Typically when you cosponsor with a Senator or a Congressman, he is listed as a cosponsor. It is not listed as his conference, per se, and we have instructed them that that is the way it should be done in the future.

Second, this conference has been going now for 6 years. It obviously is a very high powered conference. With the corporate structure they have and the fees they charge, they should be able to support the cost of this themselves, and SBA should no longer be financially involved in it.

I agree with you. I frankly consider it outrageous myself.

The CHAIRMAN. How much have these people here contributed to this thing to get their name on here as a corporate sponsor?

Mr. MOFFITT. I cannot tell you that, Senator.

The CHAIRMAN. You do not have any idea?

Mr. MOFFITT. No, I do not.

I can certainly get the information for you.

The CHAIRMAN. I would like to get that information.

[Material follows: All requested material not provided by SBA.]

SMALL BUSINESS ADMINISTRATION
Region IX

Cosponsorship Costs
for
Sen. Campbell's Women's Business Conferences
and
Sen. Campbell's Business Development Conferences

Women's Business Conference

1985			
	Printing	$17,100	
	Mailing	42,000	(1st class)
	Envelopes	6,000	
	TOTAL	$65,100	
1986			
	Printing	$22,828	
	Mailing	43,750	(1st class)
	TOTAL	$66,578	(for 350,000 brochures)
1987			
	Printing	$25,261	
	Mailing	37,500	(3rd class)
	TOTAL	$62,761	(for 350,000 brochures)
1988			
	Printing	$23,300	
	Mailing	26,000	(3rd class)
	TOTAL	$49,300	(for 300,000 brochures)

Business Development Conference

1986			
	Printing	$3,805	
	Mailing	18,750	
	TOTAL	$22,555	(150,000 brochures)
1987			
	Printing	$5,104	
	Mailing	18,750	
	TOTAL	$23,854	(150,000 brochures)

JUN 29 1988

Senator William Campbell
23161 Lake Center Drive
Suite 205
Fl Toro, California 92630

Dear Senator Campbell:

Pursuant to a request from the Senate Small Business Committee we have been requested to obtain the following information from you:

> How much funding have cosponsors, other than the SBA, provided for the brochures that have been used at your women's business and business development conferences, by each year since 1985.

On June 29th, Pat Shane of my staff, spoke with Karen Smith who said she would provide the information. This information is required by July 8. If you cannot provide the data by this date please notify us so that we might inform the Senate Small Business Committee.

Thank you for your cooperation in this matter.

Sincerely,

/s/ JB for

Cliff Downen
Assistant Administrator for
Congressional & Legislative Affairs

JUL 15 1988

Ms. Karen Smith
Conference Coordinator
23161 Lake Center Drive
Suite 206
El Toro, California 92630

Dear Ms. Smith:

In your conversation with Pat Shane by phone on Monday, July 11, you stated that cosponsors had not provided funding for Senator Campbell's brochures. The Senate Small Business Committee, however, is requesting the funding, by year, that all of the cosponsors have provided to Senator Campbell's women's business and business development conferences.

The Committee wishes to complete its report and, thus, the deadline for receiving this information has been extended to Friday, July 22. Once again, if you cannot provide this data notify us so that we might inform the Committee.

I look forward to hearing from you as soon as possible.

Sincerely,

Clifford L. Downen
Assistant Administrator for
Congressional & Legislative Affairs

OCLA/rp/7-15-88
cc: C. Downen
J. Moffitt
L. Rosenbaum
J. Ball
Wang 2478C

U.S. SMALL BUSINESS ADMINISTRATION
WASHINGTON, D.C. 20416

JUL 29 1988

Mr. John Ball
Staff Director
Committee on Small Busines
United States Senate
Washington, D.C. 20510

Dear John:

I am writing in response to your request to provide the Senate Small Business Committee with information on the financial assistance that the Small Business Administration has provided to Senator Campbell for his women and business conferences. In addition, you requested that SBA also provide the amount of funding that other cosponsors provided to Senator Campbell's conferences. This data was to be added to the hearing report of March 22, 1988.

As you know, the SBA submitted a list of costs that the Agency had provided through printing, mailing and postage since 1985.

On June 29, Karen Smith of Senator Campbell's staff was contacted by phone, by a member of my staff. During that conversation she said she would be back in touch with my office. To emphasize the importance of the request a registered letter was sent to Senator Campbell and Karen Smith on June 29, 1988. (See attached letter.)

No response was forthcoming on July 8, the appointed date to respond. Ms. Smith called July 11 to say that the cosponsors had not provided funding for the brochures.

Another registered letter was sent to Karen Smith on July 15 requesting that we be provided with an accounting of any funding cosponsors might have provided to Senator Campbell's conferences. (See second attached letter.) Again there was no response.

While I am sure it is difficult to get responses on a timely basis from the various cosponsors; I, nevertheless, am hopeful that we will yet receive the information you requested. However, I did want to give you a status report on the matter since it has gone over the allotted time.

Sincerely,

Cliff

Cliff Downen
Assistant Administrator for
Congressional & Legislative Affairs

The CHAIRMAN. And you know, one of the things that really troubles me is there is not one single small business program mentioned in this whole brochure, or this other one, for that matter, neither one of these brochures. All it says is that SBA is a co-sponsor, but there is not one word in there about one single SBA program that I can find.

Mr. MOFFITT. It appears that we are getting very little for our money.

The CHAIRMAN. I think that is the understatement of the year. I think Senator Campbell is doing very well for himself.

Mr. MOFFITT. Considering how much we apparently have spent over the years on Senator Campbell, I am surprised he is not sitting at that table with you today.

Senator WEICKER. I am surprised that NFIB has not named him Small Businessman of the Year, just on the basis of his conference.

The CHAIRMAN. Let me ask you, do we have a policy on things like this?

Do we lend ourselves to that sort of thing?

Mr. MOFFITT. For example, in Illinois we have co-sponsored conferences before with the Lieutenant Governor. Where someone asks us to cosponsor and has an interest, and we at SBA feel that we derive some benefit from it, we will cosponsor with people other than Senators or Congressmen. We do not do a lot of it, and that is by far the most extreme example. But typically it is not done very often.

The CHAIRMAN. Your budget would not permit doing it often at $60,000 each.

Mr. MOFFITT. I mean even where we expend no or little funds at all, because frequently we will cosponsor and not do anything except some minimal franking.

The CHAIRMAN. Well, Mr. Moffitt, I am going to strongly urge you to develop a policy on this sort of thing, and I would like for you to do that voluntarily, without us having to ask you to do it through some formal piece of legislation here.

Senator ABDNOR. Mr. Chairman, I would like to say, the reason we became aware of this was because of the consistency policy I asked for when I came to SBA. The Comptroller is reviewing the consistency of our mailings throughout the country, and that is how he stumbled into this.

Mr. ROSENBAUM. It was too late once we found it, Mr. Chairman. But as a result of the overall agency policy of consistency, we try to look at programs and their delivery systems within the agency and review them to make sure that they are consistent across the board. In doing this, we did stumble onto this issue.

Unfortunately, commitments had already been made and we felt we had to go along with it. But I assure you that this will not occur next year.

Mr. MOFFITT. I think, Senator, you are talking about a policy as to the appropriateness of who we cosponsor with.

The CHAIRMAN. Yes, this is obviously a political thing. They are all political to some extent, but this is really flagrant.

We are picking up probably the lion's share of the money here. Some of these people are obviously paid honorariums to come out

there. He has some really top-drawer people, and I imagine anybody that attended felt that they got their money's worth.

But as I say, this is no Small Business Conference for Women. They talk about a lot of things, but they do not talk about small business programs that would warrant our involvement to the tune of 60,000 smokes.

I can remember a couple of years ago the Commerce Department, and maybe they still do it, held regional and Statewide Federal procurement conferences for small business. And we had one in Little Rock a couple of years ago, and the Commerce Department and Small Business collaborated on it, and we had a lot of people come there, and we had a tremendous attendance, and it was on promoting Federal procurement opportunities by small business.

It was one of the best conferences I ever attended. It was really dynamite. And the whole conference really did not cost half what this thing cost.

So I think that before you spend any more money—and incidentally, what budget does the 60 grand come out of?

Mr. MOFFITT. It would come out of our printing and postage budget.

The CHAIRMAN. How much do you have in that?

Mr. ROSENBAUM. Right now that is part of our overall salaries and expense budget. Right now printing and postage, we have $1.5 million in our postage budget, and $5 million nationwide in our printing budget.

The CHAIRMAN. OK.

Mr. ROSENBAUM. In terms of policy determination, my office, in cooperation with the Office of Business Development, which handles a lot of the cosponsored events in the agency, has put together a draft document to be submitted to Mr. Moffitt and to the Senator. It is targeted to go out by the end of the month, with new operating budget controls on cosponsored mailings.

The CHAIRMAN. When you finalize that, I wish you would submit it to this Committee for our consideration.

Mr. ROSENBAUM. Yes, sir. It has already been drafted. It is just a matter of getting final clearance and we will submit it.

Mr. MOFFITT. Again, Senator, this would be exclusively on the financial control aspect of it and not on the appropriateness. We will have to develop that policy in a separate mechanism.

Historically what has happened is there really has been no direct control over franking. Each region or district would frank as they saw fit, and our cost of franking would continue to mount.

So just recently we have asked all districts and regions to submit all franking requests to central office, so that we would have an opportunity to review. As a matter of fact, that is how that originally came to our attention, not how the flyer was printed but the cost of it.

So we have developed a policy by which we are going to give each region an allotment that they cannot exceed for franking, and that is what Mr. Rosenbaum is talking about.

The CHAIRMAN. Fine.

Senator Abdnor and gentlemen, thank you very much.

Senator ABDNOR. In closing, I know you are a very, very busy man, Mr. Chairman, but some time just take a look at our exporters guide. That is something that we printed up involving the other departments and the agencies in Government. I do not think we have ever had anything like it in the Federal Government.

It is a summary of all agency programs relating to international trade. It lists the agency representatives that people can contact. They have the talking points on international trade. It has a speakers bureau if you want people to go out. It has general information on exporting.

We have just finished the second of 10 regional conferences on international trade, and we are not doing it alone. We are kind of the catalyst, and we had the Export-Import Bank, all of the other agencies including Commerce helping us with this. And it is really working out great.

We are going to hold, I think, 600 or 700 of these within the States on a smaller scale after these are done, because there is a lot of interest in this.

We also provide a similar effort on our Rural Development Program. We have just finished 10 conferences there. We have reported our success to the Governors and they are very interested. Again, we had the other agencies in Government helping us: the Department of Agriculture, HUD, Commerce. It has been a great thing.

And now we are asking the Governors to cosponsor conferences in their States, so we can break it down and really get things rolling.

The third program we are really working on is for young entrepreneurs. Again, this is a whole new program involving the college age and even younger. We are just getting that off the ground. And again, we think that is going to have a real impact.

These are great programs, a little different than what has been stressed in the past. But I think it is also the first time where we have tried to bring all the agencies together to work. We have been saying, really, there are enough programs for all the rural development, and for international trade, but most of the time businesses do not have the slightest idea what they are or where to find them.

Here we are all going out and telling them what we have and offering our help, instead of telling them what to do: We are here to help them. We have been meeting with quite a bit of success and we are quite pleased with it. I just thought I would tell you about that.

The CHAIRMAN. Those are all steps in the right direction, Jim, especially the one on exports. I continue to believe that most small businesses could export, but they do not know how and they do not want to take the trouble. They are afraid there is too much redtape to it or they just do not want to mess with it.

And booklets like that, properly circulated to the right people, could really make a big difference.

Senator ABDNOR. With everyone working together.

The CHAIRMAN. Thank you again for coming over.

Mr. ROSENBAUM. Thank you, Mr. Chairman.

The CHAIRMAN. Ms. Price, welcome to the Committee. If you can summarize your statement, we would appreciate it. If you cannot, we will understand.

STATEMENT OF JOANN H. PRICE, PRESIDENT, NATIONAL ASSOCIATION OF INVESTMENT COMPANIES, WASHINGTON, DC

Ms. PRICE. Thank you, Mr. Chairman. I will summarize my statement and I would like our entire statement to be submitted for the record.

The CHAIRMAN. It will be admitted for the record.

Ms. PRICE. I am Joann Price, president of the National Association of Investment Companies, representing the MESBIC's across the country to discuss with you today the administration's budget proposal.

As you know, the proposal calls for the complete elimination of all the special incentive subsidies to MESBIC's, preferred stock and the interest rate subsidy. As you know, Mr. Chairman, we have been before this Committee 5 consecutive years to defend in one way or another the MESBIC Program, the SBA in general, and the total reason for our existence.

We are very concerned this year about the fiscal year 1989 budget, because it calls for the total elimination of all of the incentives that we have had over the last 15 years. And of course, inherent in this budget proposal, because they are not suggesting any new legislative changes, the MESBIC's would continue to be required to invest in minority firms, and of course we would like to see this continue.

But tell me, Mr. Chairman, would the MESBIC's really continue to exist without subsidies and be expected to invest in our market, doing the same things that the regular SBIC's are currently doing, and continue to stay in this business? Would the MESBIC's want to exist under this present budget proposal? The answer is no.

Would the MESBIC Program continue to exist under this budget proposal? The answer is no.

Would the minority business community have access to venture capital under this proposal? The answer is no.

And getting to the root of it all, does this Administration support this industry? The answer is definitely no.

Just to go back a little bit, Mr. Chairman—and I know you have heard some of this history, but just to go back to our roots, so to speak—this industry came out of the 1968 era of the Nixon black capitalism. It was addressing the issue of prejudice and discrimination across the country. At that time we were talking mostly about black Americans and, as you know, this industry has expanded to Hispanics, Native Americans, Asian Americans, many of our new immigrants into this country.

We were talking about a country that had discrimination at every level in our education system, in job opportunities, in our housing markets all across the country. This Committee—not this Committee, but the Subcommittee of the Banking Committee—looked to see what it could do to begin to address the issue of economic and business development in the minority community across the country.

And I think to their benefit, they came up with this specialized program, the Small Business Investment Company Program. They combined the best of the Government's thinking with the private sector, and they created an industry that would be looking to invest in minority firms across this country.

And look what has happened. It has combined and addressed the social and economic concerns. The outgrowth of this policy has been the creation of a diversity of minority businesses across the country, a talent pool of entrepreneurs that are constantly growing, and it provides opportunity for new citizens coming to this country.

And one of the very unique things that we do not often talk about, Mr. Chairman, and it has created a talent pool within this industry, within this very specialized venture capital industry that I am talking to you today, the executives and the venture capitalists that are specialists in investing in minority firms across this country.

We are most concerned because the resources of the private sector are committed to this industry. As you know, in the regulations and in the mandate, we must lose every dollar of our private funds before the SBA is at risk.

We are very concerned over the past several years that SBA has stressed that we no longer need these subsidies. They are concerned that we are not passing these subsidies through to the small business concerns, and since we are not doing this they are saying that the MESBIC's are not entitled to this particular subsidy.

And today, Mr. Chairman, I would like to take to task each one of those specific arguments that Mr. Holloway again suggested in his verbal testimony before you just a few minutes ago.

The SBA argument is totally false. The purpose of the subsidies to this industry were very specific. It is rooted in our legislative history. They were provided to encourage private investors to invest in a very narrow market. It was done so that the Tower Ventures, the Equitable Capitals, the Metropolitan Lifes, the Prudentials, and many other corporate America citizens across the country as well as corporate America would invest in this industry.

It was to encourage active participation by those corporations to invest in the minority community. It is very important to understand that, and to be absolutely practical about it, why would a MESBIC continue to exist, continue to operate in a narrow market, continue to invest in the highest risk group of businesspeople, and compete against the regular SBIC's that do not have those restrictions, and want to exist?

It just does not make any rational or reasonable sense, and in fact it is an insult. This industry simply would not exist or the MESBIC's would convert and become SBIC's. And if I were operating one of the investment companies, that is exactly what I would do.

The second issue that SBA brought up today and that was brought up in a letter to Congressman Conyers on the House side is the issue of management assistance, which was used to further justify the reason we do not need subsidies any longer.

If you will look at the form that the SBIC's have to report on to indicate whether or not they are providing management assistance,

that form was designed to determine whether investment companies were charging to provide management assistance to small business concerns, which of course they are allowed to do under the regulations.

In 2 percent of the cases, the MESBIC's responded that, yes, they were providing that assistance for a fee. I can guarantee you, Mr. Chairman, that the MESBIC's across the country work with the small business concerns on a regular basis. They are serving on boards, they serve on committees.

They are in those companies when they are in trouble. They are called on day and night, the hand-holding that goes on. We have a lot of money at risk in these companies, and I can assure you that we do not have a hands-off approach when we are working with the companies that we invest in.

So we resent the misuse of that particular statistic and indicate that that is absolutely false.

Further, Mr. Chairman, on the issue of equity. And we have heard this time and again, and we have been criticized, not only most recently by the SBA, but we have been criticized by the House and Senate Small Business Committees about, why are we not providing enough equity to the small businesses?

And I want to stop and talk a little bit about what that means. It is easy for us to talk about equity in a policy sense. But equity means that we have to have an opportunity to exit from these deals, that we have to have a market for the securities that we purchase in these companies.

Across the country today, there are approximately 12 minority firms who are publicly held, 12. That means that when we purchase equity in companies, we have to get out of these companies. We have to be able to reinvest this money into other firms.

How do we do it? Over the last couple of years, and I think it is to our credit, we have been able to find markets for the deals that we are doing. We find companies who are willing to purchase some of our equity, some of our equity from these companies.

We have found situations where we have been able to sell some of the companies. So we have created a market. But I assure you, equity is all well and good, but if you are staying in a firm 10, 12, 15 years because there is no market and we cannot get out of that deal, equity is fine in terms of rhetorical discussion, but in actual practice equity is very difficult.

So what we do is to begin to invest in other forms, subordinated debt-equity features, and other ways that we can provide our companies some liquidity. We have had one company that we have had before you over the years, it is a very attractive company. It makes great press, it makes great copy. But the truth of the matter is that we have had eight MESBIC's in that deal until last year, over 12 years.

Twelve years that firm had the use of our funds, with no market to exit from that particular deal. So we do subordinated debentures. We are subordinated to all other lenders, and that is the form of equity. We do long term—we do moratoriums on principal.

We do everything we can to provide other options and instruments so that that is self-liquidating. So although I am sensitive to it, I understand, going back to some of our history and our man-

date, it is all well and good to talk about equity, but in practical terms we have to be able to exit from these deals.

And finally, Mr. Chairman, the Administration's discussion about the budget proposal and their claim that we can survive without the special incentives. And the assumption inherent in their claim is that private investors will continue to invest in the MESBIC industry even when the special incentives are removed.

We need only to look at what has happened in private investments in MESBIC's over the last several years. In 1980 when our funding was stable and investors were confident of the availability of our special incentives, we had a private capital growth rate of 27 percent. By last year, with our funding uncertainty, that caused our growth to fall from 27 to 1 percent.

The CHAIRMAN. What did you say caused that 27 to 1 percent? What did you say caused that?

Ms. PRICE. Our investor uncertainty in the last 5 years in terms of not knowing whether we were going to be in business or out of business, especially for new people looking to come into the industry. It does not give one too much hope for long-term stability.

And for every company that entered the industry last year, three left. This is the private sector's response to uncertainty of our special incentives. I leave it to you to predict its response to the complete elimination of these incentives.

Perhaps the Administration is assuming that the minority business community no longer needs the MESBIC industry, that there is a sufficient level of private sector investment in the minority business community without the MESBIC's. There are some non-MESBIC's that specialize in minority investing, and all of those companies function and work with the MESBIC's very specifically.

There are insurance companies that work with us in syndication of some of our larger deals, as Herb Wilkins has told you in the past, some of the communication properties that he specializes in. We have some State and local funds that have been developed that stress minority financing. All of those funds work very closely with the MESBIC's and take advantage of the expertise that we have developed.

And for every dollar of capital that we have invested in a business, we are able to bring $2 of additional capital into that same business.

If you look at some of the big names in minority business—John Johnson, Reggie Lewis, who recently purchased Beatrice Foods, Ed Lewis and others that you have heard about—all of them have dealings with this industry.

Yet this is the same industry from which the Administration wants to withdraw its special incentives, the same industry that has tried—they have tried to eliminate in the past 5 years, the same industry that last year alone invested $143 million and attracted an additional $286 million to the minority businesses that we serve.

This is the same industry that has created 17,600 jobs and generated $136 million in tax revenues with those investments. And this is the same industry that, unless we receive that assistance in the deliberate attempts by the Administration to curtail what we do, we will surely be extinct.

Thank you, Mr. Chairman, for allowing us to come before you today to discuss how seriously we feel about this current budget proposal. It is one that, quite frankly, we are puzzled by because, although they have looked to cut back the regular SBIC's, they are looking to totally eliminate the specialized side of the investment company industry, and it is very puzzling, very puzzling for us as an industry and very sad, I think, for this Administration's commitment to minority business development.

Thank you.

[The prepared statement of Ms. Price follows:]

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TESTIMONY

BY

JOANN H. PRICE

PRESIDENT

OF

NATIONAL ASSOCIATION OF INVESTMENT COMPANIES

BEFORE THE

SENATE SMALL BUSINESS COMMITTEE

MARCH 22, 1988

Vice Chairman
DONALD F. GREENE
Minority Equity Capital Company, Inc.
New York, New York

Secretary
RALPH L. McNEAL, SR.
North Street Capital Corporation
White Plains, New York

Treasurer
ALVIN MURSTEIN
Medallion Funding Corporation
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Triad Capital Corporation of New York
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Lafayette, Louisiana

DR. HYO H. BYUN
Peterson Finance & Investment Company
Chicago, Illinois

DAVID DER
Asian American Capital Corporation
Hayward, California

OSCAR FIGUEROA
Rutgers Minority Investment Company
Newark, New Jersey

JAMES KOBUS
Motor Enterprises, Inc.
Detroit, Michigan

J. PETER THOMPSON
Opportunity Capital Corporation
San Francisco, California

JAMES S. YU
Intercontinental Capital Funding Corporation
New York, New York

GOOD MORNING, CHAIRMAN RUMPERS AND MEMBERS OF THE COMMITTEE. I AM JOANN PRICE, PRESIDENT OF THE NATIONAL ASSOCIATION OF INVESTMENT COMPANIES (NAIC), THE TRADE ASSOCIATION REPRESENTING THE MINORITY ENTERPRISE SMALL BUSINESS INVESTMENT COMPANY (MESBIC) INDUSTRY. I AM PLEASED TO HAVE THE OPPORTUNITY TO APPEAR BEFORE YOU TODAY TO DISCUSS THE ADMINISTRATION'S BUDGET FOR FISCAL YEAR 1989, AND IN PARTICULAR THAT PORTION OF THE BUDGET PERTAINING TO THE MESBIC INDUSTRY.

THE ADMINISTRATION'S BUDGET PROPOSAL CALLS FOR THE COMPLETE ELIMINATION OF SPECIAL INCENTIVES TO MESBICS TO INVEST IN MINORITY OWNED SMALL BUSINESSES. THEY PROPOSE TO CEASE SBA PURCHASES OF PREFERRED STOCK IN MESBICS, AND TO DISCONTINUE THE INTEREST RATE SUBSIDIES MESBICS CURRENTLY RECEIVE WHEN THEY BORROW FROM THE SBA. INSTEAD, IT IS PROPOSED THAT MESBICS GO TO THE SBIC FUNDING CORPORATION FOR LEVERAGE, RECEIVING FUNDS ON THE EXACT SAME TERMS AS REGULAR SBICS.

THIS IS NOT THE FIRST TIME THE ADMINISTRATION HAS ATTACKED OUR FUNDING. IN FACT, FOR THE PAST FIVE YEARS WE HAVE APPEARED BEFORE THE COMMITTEE TO PRESENT TESTIMONY URGING YOU NOT TO FOLLOW THE ADMINISTRATION'S RECOMMENDATIONS TO KILL THE MESBIC INDUSTRY. IN FISCAL YEAR 1985'S BUDGET, THE ADMINISTRATION WANTED TO ELIMINATE THE ENTIRE SMALL BUSINESS ADMINISTRATION, AND THE MESBIC PROGRAM ALONG WITH IT. IN 1986 AND 1987, THEY CONTINUED THEIR EFFORTS TO ELIMINATE THE SBA. IN FISCAL YEAR 1988, THE ADMINISTRATION WANTED TO CUT OUR FUNDING IN HALF, KNOWING THAT WE WERE ALREADY EXPERIENCING FUNDING APPLICATION BACKLOGS OF SIX MONTHS OR MORE. NOW, IN FISCAL YEAR 1989'S BUDGET, THE ADMINISTRATION PROPOSES TO ELIMINATE ALL SPECIAL INCENTIVES TO THE MESBIC INDUSTRY.

ALTHOUGH EACH OF THESE PROPOSALS WOULD HAVE HAD THE SAME EFFECT--ELIMINATING THE MESBIC INDUSTRY--THIS YEAR'S PROPOSAL IS THE MOST DISTURBING. IN FISCAL YEARS 1985 THROUGH 1987, THE ADMINISTRATION WAS ATTACKING THE SBA AS AN AGENCY, AND NOT OUR PROGRAM IN PARTICULAR. IN FISCAL YEAR 1988'S BUDGET PROPOSAL, THE ADMINISTRATION MADE A HALF-HEARTED ATTEMPT TO PRESERVE THE PROGRAM BY CUTTING OUR DIRECT FUNDING IN HALF. BUT THIS YEAR'S PROPOSAL IS THE DEADLIEST OF ALL. THE ATTACK IS AIMED AT THE MESBIC PROGRAM IN PARTICULAR, AND, DESPITE ITS INNOCENT APPEARANCE, IT WOULD RESULT IN THE FULL-SCALE EXDOUS OF LICENSEES FROM THE MESBIC PROGRAM.

ON ITS FACE, THE ADMINISTRATION'S PROPOSAL LOOKS LIKE A MOVE TOWARD PRIVATIZATION. THE SBA WOULD SIMPLY TAKE WHAT IS NOW A DIRECT LOAN PROGRAM AND MAKE IT A GUARANTEED LOAN PROGRAM. IN THE PROCESS, HOWEVER, THEY WILL ALSO REMOVE THE INCENTIVES TO BE IN THE PROGRAM. LET'S LOOK MORE CLOSELY AT WHAT THE ADMINISTRATION'S PROPOSAL WOULD DO.

THE ADMINISTRATION PROPOSES THAT MESBICS RECEIVE LEVERAGE FROM THE SBIC FUNDING CORPORATION UNDER THE SAME TERMS AND CONDITIONS AS REGULAR SBICS. AS MESBICS, HOWEVER, THEY WOULD CONTINUE TO BE LIMITED IN THEIR INVESTMENTS TO THOSE COMPANIES THAT ARE SOCIALLY OR ECONOMICALLY DISADVANTAGED. NOW--YOU TELL ME--WOULD YOU PAY THE SAME RATES FOR FUNDS AS THE GUY NEXT TO YOU, BUT LIMIT YOUR USE OF THOSE FUNDS TO THE RISKIEST 6% OF HIS POTENTIAL USE OF THOSE SAME FUNDS? **NO!** WOULD MESBICS <u>WANT</u> TO EXIST UNDER THIS BUDGET PROPOSAL? **NO!** <u>WILL</u> THE MESBIC PROGRAM CONTINUE TO EXIST UNDER THIS BUDGET PROPOSAL? **NO!** WILL THE MINORITY BUSINESS COMMUNITY CONTINUE TO HAVE ACCESS TO

VENTURE CAPITAL UNDER THIS PROPOSAL? **NO!** AND, GETTING TO THE ROOT OF IT ALL, DOES THIS ADMINISTRATION SUPPORT THE CONTINUATION OF THE MINORITY VENTURE CAPITAL PROGRAM? **NO!**

AT THIS POINT, I THINK IT WOULD BE HELPFUL TO PROVIDE A HISTORICAL PERSPECTIVE ON THE PURPOSE OF THE MESBIC PROGRAM.

THE PURPOSE OF THE MESBIC PROGRAM

THE EARLY 1970'S WERE A VERY IMPORTANT PERIOD IN THE DEVELOPMENT OF THE MINORITY COMMUNITY. AFTER YEARS OF STRUGGLE, WE WERE FINALLY PUTTING AN END TO SCHOOL SEGREGATION. CITIES WERE LOOKING FOR CONSTRUCTIVE PLANS TO RECOVER FROM THE EARLIER RACE RIOTS, AND TO INSURE THATY THEY DID NOT OCCUR AGAIN. IMPORTANT LEGAL AND LEGISLATIVE GAINS HAD BEEN MADE IN THE SIXTIES, BUT IT WAS LEFT TO THE SEVENTIES TO SEE TO THEIR ORDERLY IMPLEMENTATION. THE EDUCATIONAL AND OCCUPATIONAL RACISM OF THE PAST LEFT THE MINORITY COMMUNITY AT A DISADVANTAGE IN THE BUSINESS ARENA. PRIVATE SECTOR INVESTORS VIEWED MINORITY ENTREPRENEURS AS BEING TOO HIGH RISK.

THUS, THE MESBIC PROGRAM WAS FORMED TO ADDRESS A NEED THAT WAS NOT BEING MET BY THE SBICs OR TRADITIONAL VENTURE CAPITALISTS. MINORITY-OWNED BUSINESSES IN 1972 ACCOUNTED FOR ONLY 3.7% OF THE TOTAL NUMBER OF BUSINESSES IN THE U.S., AND FOR ONLY ONE HALF OF ONE PERCENT OF U.S. BUSINESS RECEIPTS.

THE GOVERNMENT WANTED TO ADDRESS THIS NEED, BUT WISELY CHOSE TO DO SO BY CREATING A PUBLIC/PRIVATE SECTOR PARTNERSHIP PROGRAM MODELED

AFTER THE EXISTING SMALL BUSINESS INVESTMENT COMPANY PROGRAM. UNDER THE MESBIC PARTNERSHIP, THE GOVERNMENT INDUCED PRIVATE SECTOR INVESTORS TO INVEST IN MINORITY-OWNED BUSINESSES BY PROVIDING THEM WITH MATCHING FUNDS AT SUBSIDIZED RATES.

THE NEW PROGRAM WAS ATTRACTIVE TO PRIVATE INVESTORS, BECAUSE THE LOW-COST FUNDS, AND THEIR RESULTANT WIDENING OF THE MESBIC'S ASSET BASE, HELPED TO COMPENSATE THE INVESTORS FOR THE HIGHER RISK THEY ACCEPTED IN INVESTING ONLY IN MINORITY-OWNED FIRMS. THE PROGRAM WAS ATTRACTIVE TO THE GOVERNMENT BECAUSE IT WAS ABLE TO ACHIEVE ITS PUBLIC POLICY GOAL OF FUNNELLING VENTURE CAPITAL TO THE MINORITY BUSINESS COMMUNITY AT A MINIMAL COST TO THE GOVERNMENT. THE PRIVATE SECTOR INVESTORS SET UP THE INVESTMENT COMPANIES, HIRED AND TRAINED THE INVESTMENT PROFESSIONALS, AND AGREED THAT IF THE COMPANY WERE TO EXPERIENCE ANY LOSSES, THEY WOULD COME FIRST FROM PRIVATE CAPITAL. THE GOVERNMENT DOES NOT LOSE A SINGLE DOLLAR OF ITS INVESTMENT IN A MESBIC UNTIL THE PRIVATE INVESTOR HAS LOST ALL OF HIS INVESTED DOLLARS.

MY PURPOSE FOR PROVIDING YOU WITH THIS HISTORICAL PERSPECTIVE ON THE MESBIC PROGRAM IS TO GIVE YOU A CLEARER IMAGE OF WHAT THE FOUNDERS OF THIS PROGRAM HAD IN MIND WHEN THEY DEVELOPED THE SPECIAL INCENTIVES THAT MADE THE MESBIC PROGRAM WHAT IT IS TODAY. BUT ON SEVERAL OCCASIONS WITHIN THE PAST YEAR, ADMINISTRATION OFFICIALS HAVE MISREPRESENTED THE PURPOSE OF THESE INCENTIVES. AT THIS PONT, I WOULD LIKE TO TAKE THE OPPORTUNITY TO RESPOND TO THEIR ALLEGATIONS.

Purpose of MESBIC Incentives

In testimony presented to the House Small Business Committee on December 10 of last year, and on several subsequent occasions, the SBA has suggested that MESBICs have not lived up to their mandate for receiving their special incentives. The SBA has even gone so far as to allege that, instead of providing the special mandate services for which we receive our subsidies, we are abusing the program. We resent these allegations, and wish to put them to rest now.

Cost of Money to Small Business Concerns

The SBA has criticized MESBICs for charging their portfolio companies interest rates similar to those charged by SBICs. They suggest that our lower cost of money should be passed through to the minority businesses in which we invest. The whole point of the MESBIC program is that we are NOT assuming the same level of risk as regular SBICs. Minority-owned companies account for only 5% of their eligible pool of investments, and its is the highest risk area of that pool.

Typically, for investors to accept a high risk investment, they will demand a higher rate of return. Minorities should not be forced to pay more for their funds, so the subsidies offered through the MESBIC program are meant to go to the INVESTORS to help compensate for that higher risk. It was never meant to be a pass-through to our small businesses. If we did that, there would be no incentive left for the investors. The incentives were meant to "level the playing

FIELD" FOR MESBICs WITH OTHER SBICs. THE FACT THAT SOME COMPANIES ARE CHARGING INTEREST RATES COMPARABLE TO OTHER SBICs SHOULD NOT BE INTERPRETED TO MEAN THAT MESBICs HAVE IN SOME WAY VIOLATED THEIR MANDATE.

MANAGEMENT ASSISTANCE TO SMALL BUSINESSES

IN A RECENT LETTER FROM SBA ASSOCIATE ADMINISTRATOR FOR FINANCE AND INVESTMENT EDWIN T. HOLLOWAY TO CONGRESSMAN JOHN CONYERS, JR., MR. HOLLOWAY MENTIONED THAT ONE OF THE PURPOSES OF PREFERRED STOCK LEVERAGE TO MESBICs WAS TO DEFRAY THE COST OF PROVIDING MANAGEMENT ASSISTANCE TO THEIR PORTFOLIO CONCERNS. HE THEN WENT ON TO STATE, "...A REVIEW OF THE PORTFOLIO FINANCING REPORTS FILED BY MESBICs WITH SBA FOR THE CALENDAR YEAR 1987 SHOWS THAT WHEN MESBICs WERE ASKED IF THEY PROVIDE MANAGEMENT SERVICES TO THE FINANCED SMALL BUSINESS CONCERNS, IN 84% OF THE CASES THEY ANSWERED 'NO', 2% ANSWERED 'YES', AND 14% DID NOT ANSWER THE QUESTION. WE MUST CONCLUDE THEREFORE THAT THEY ARE NOT IN A MAJORITY OF THE CASES INCURRING THE ADDED COSTS OF SUCH ASSISTANCE. THE MESBICs, OR THEIR OWNERS AND MANAGERS MUST THEREFORE BE BENEFITTING FROM THE SUBSIDY WHICH IS NOT BEING USED AS INTENDED."

WE RESENT THIS IMPLICATION. THE SBA HAS MISREPRESENTED THE FACTS. THE QUESTION REGARDING MANAGEMENT SERVICES TO WHICH MR. HOLLOWAY ALLUDES DOES NOT REFER TO THE PROVISION OF MANAGEMENT SERVICES TO SMALL BUSINESSES, BUT TO WHETHER OR NOT THE MESBIC <u>CHARGES</u> ITS PORTFOLIO COMPANIES FOR THE MANAGEMENT ASSISTANCE IT PROVIDES. THUS, THE SURVEY INDICATES THAT ONLY 2% OF MESBICs ARE COMPENSATED BY THEIR COMPANIES FOR MANAGEMENT SERVICES, NOT THAT 2% PROVIDE MANAGEMENT SERVICES.

Equity Investments in Small Businesses

On several occasions, the SBA has criticized the MESBIC program for what it characterizes as our low rate of equity investments. They point in particular to our 1987 investments in small businesses, noting that 12% were in debt/equity instruments, and 9% were in straight equity. Thus, they would have you believe, 79% of our investments are in secure debt instruments. We contest their claims on several counts.

First, the SBA defines equity only in terms of stock at any type. Our investments are then subordinated to all other investors in our companies. Even when we make loans to companies, they tend to be a much different kind of loan than most venture capitalists make. We often provide moratoriums on the payment of principal and other similar arrangements. Our average investments run between seven and eight years. And, when our compaies fail, the combination of their usually-limited assets and our subordinated position mean that when we lose, we lose <u>BIG</u>.

Second, we face a very different situation from other SBICs in terms of our ability to exit from our equity investments. Other venture capitalists can exit from a deal by selling their stock to third parties. It is only within the last two years that we have even <u>BEGUN</u> to find a means to successfully exit from our deals. In the entire country, there are only ten to twelve minority owned companies that have gone public. Our subordinated debt instruments, as one example, are self-liquidating, thus providing an automatic exit.

THIRD, WHEN YOU LOOK AT VENTURE CAPITAL FUNDS THAT ARE ABLE TO PROVIDE A SIGNIFICANT LEVEL OF EQUITY TO THEIR INVESTEES, YOU SEE A PROFILE VERY DIFFERENT FROM THAT OF MOST MESBICs. OPERATING EXPERIENCE AND LARGE CAPITAL BASES ARE USUALLY FOUND AMONG PREDOMINANTLY EQUITY INVESTORS. WITHIN THE SBIC INDUSTRY, SBICs WITH OVER 70% EQUITY INVESTMENTS HAVE AN AVERAGE ASSET BASE OF OVER $18 MILLION. SBICs WITH OVER 70% LOANS, ON THE OTHER HAND, HAVE AN AVERAGE ASSET BASE OF $4 MILLION. MESBICs HAVE AN AVERAGE ASSET BASE OF ONLY $3 MILLION, AND THUS LACK THE LARGE ASSET BASE REQUIRED TO FINANCE A HIGH LEVEL OF PURE EQUITY INVESTMENTS. THIS NECESSITATES CAUTION IN OUR INVESTMENT STRATEGIES.

ELIMINATION OF MESBIC INCENTIVES

FINALLY, I WANT TO ADDRESS THE ADMINISTRATION'S CLAIMS BEFORE THIS COMMITTEE THAT THE MESBIC INDUSTRY CAN SURVIVE WITHOUT SPECIAL INCENTIVES. THE ASSUMPTION INHERENT IN THEIR CLAIMS IS THAT PRIVATE INVESTORS WILL CONTINUE TO INVEST IN THE MESBIC INDUSTRY EVEN WHEN THE SPECIAL INCENTIVES ARE REMOVED. ONE NEED ONLY LOOK AT WHAT HAS HAPPENED TO PRIVATE INVESTMENTS IN MESBICS DURING THE RECENT SHORTAGE OF THESE INCENTIVES TO UNDERSTAND THE FALLACY OF THAT ARGUMENT.

IN 1980, WEHN OUR FUNDING WAS STABLE AND INVESTORS WERE CONFIDENT OF THE AVAILABILITY OF OUR SPECIAL INCENTIVES, WE HAD A PRIVATE CAPITAL GROWTH RATE OF 27%. BY LAST YEAR, HOWEVER, OUR FUNDING UNCERTAINTY HAD CAUSED THAT GROWTH TO FALL FROM 27% TO LESS THAN 1%. AND FOR EVERY COMPANY THAT ENTERED THE INDUSTRY LAST YEAR, THREE LEFT. IF THIS IS THE PRIVATE SECTOR'S RESPONSE TO THE UNCERTAINTY OF OUR SPECIAL INCEN-

TIVES, I LEAVE IT TO YOU TO PREDICT ITS RESPONSE TO THE COMPLETE ELIMINATION OF THOSE INCENTIVES.

PERHAPS THE ADMINISTRATION IS ASSUMING THAT THE MINORITY BUSINESS COMMUNITY NO LONGER NEEDS THE MESBIC INDUSTRY--THAT THERE IS A SUFFICIENT LEVEL OF PRIVATE SECTOR INVESTMENT IN THE MINORITY BUSINESS COMMUNITY WITHOUT MESBICS. ALTHOUGH THERE IS A LIMITED LEVEL OF RESOURCES BEING MADE AVAILABLE TO THE MINORITY BUSINESS COMMUNITY FROM OUTSIDE THE MESBIC INDUSTRY, IT IS IMPORTANT TO BE AWARE THAT IN MANY CASES THEY LOOK TO US FOR OUR EXPERTISE. FOR EVERY DOLLAR A MESBIC INVESTS IN A MINORITY OWNED SMALL BUSINESS, OTHER PRIVATE SECTOR INVESTORS WILL INVEST TWO DOLLARS, BUT ONLY AFTER WE HAVE TAKEN THE POSITION OF FIRST RISK. IF YOU LOOK AT THE MAJOR BANKS AND INSURANCE COMPANIES, THEY EITHER CONDUCT THEIR MINORITY INVESTMENTS THROUGH THE MESBIC PROGRAM, OR THEIR INVESTMENT FUNDS LOOK FOR SYNDICATIONS WITH MESBICS. IF YOU LOOK AT THE FEW BIG MINORITY VENTURE CAPITAL FUNDS OUTSIDE OF THE MESBIC INDUSTRY, YOU WILL FIND THEIR EXECUTIVES COMING TO US LOOKING FOR DEALS. IF YOU LOOK AT THE BIG NAMES IN MINORITY BUSINESS--JOHN JOHNSON, CHAIRMAN OF JOHNSON PUBLISHING CO., REGGIE LEWIS, WHO RECENTLY PUT TOGETHER THE LEVERAGED BUY-OUT OF BEATRICE FOODS, AND ED LEWIS, PUBLISHER OF BLACK ENTERPRISE, AND MANY OTHERS, THEY ALL HAVE TIES TO THE MESBIC INDUSTRY.

YET THIS IS THE **SAME** INDUSTRY FROM WHICH THE ADMINISTRATION WANTS TO WITHDRAW ITS SPECIAL INCENTIVES. THE **SAME** INDUSTRY IT HAS TRIED TO ELIMINATE FOR THE PAST FIVE YEARS. THE **SAME** INDUSTRY THAT LAST YEAR ALONE INVESTED $143 MILLION AND ATTRACTED AN ADDITIONAL $286 MILLION TO THE MINORITY SMALL BUSINESS COMMUNITY. THE **SAME**

INDUSTRY THAT CREATED OVER 17,600 JOBS AND GENERATED $136 MILLION IN TAX REVENUES WITH THOSE INVESTMENTS. AND THE SAME INDUSTRY THAT, UNLESS WE RECIEVE YOUR ASSISTANCE IN STOPPING THE ADMINISTRATION'S DELIBERATE ATTEMPTS TO ELIMINATE US, WILL SURELY BECOME EXTINCT.

THANK YOU.

The CHAIRMAN. Thank you very much, Joann. Let me ask you three or four questions, because I want to understand how you work.

First of all, you should not lose any sleep about losing this program. It is not going to be lost. It will be funded at probably no smaller level than it was last year, in my opinion.

Now, how many MESBIC's are there?

Ms. PRICE. There are 128 active MESBIC's right now, 128.

The CHAIRMAN. OK. Now, you borrow money from the SBA at 3 percent, is that correct? You issued your debentures and SBA buys them?

Ms. PRICE. We borrow money at 3 percent below the Treasury rate.

The CHAIRMAN. It is 3 percent below the Treasury rate?

Ms. PRICE. Yes, for the debentures. It is a 3 percent subsidy. We purchase 10 year debentures. We get a 3 percent subsidy for 5 years, and then it goes back to the rate, the original Treasury rate, the second 5 years.

The CHAIRMAN. The cost of money to the Government after 5 years?

Ms. PRICE. Yes.

And then the other types, the other incentive that we get, of course, is the preferred stock, which is 3 percent cumulative. SBA purchases stock in our MESBIC's and their rate is 3 percent cumulative.

The CHAIRMAN. I assume that you operate, except for a little bigger subsidy in your interest rates, you operate exactly the way the SBIC's operate, do you not?

Ms. PRICE. Yes.

The CHAIRMAN. You are just dealing with minorities?

Ms. PRICE. Yes.

The CHAIRMAN. A MESBIC will normally take an equitable position in any firm that it decides to get into, is that correct?

Ms. PRICE. Well, the MESBIC will do a combination of things. They will do some debt-equity features. You do not have very many MESBIC's that are doing pure equity investments, but you will have quite a few that do debt-equity types of features. Some will do subordinated loans, subordinate to all senior lenders like banks and others.

You have some—the other piece of this, of course, is where you can often attract a variety of different capital to a particular deal, often for MESBIC's we are the only capital that they can attract to a deal. So that often you will have just one investor in a deal, and they would be providing a loan, but it may not be subordinated because there is no one to subordinate it to.

The CHAIRMAN. What is the value of the portfolios of all of those 100 and some MESBIC's? Do you have any idea?

Ms. PRICE. The value, the total asset value of the portfolio?

The CHAIRMAN. Yes. For example is it $700 million and something that the Treasury holds in SBIC debentures?

[Pause.]

The CHAIRMAN. How much have MESBIC's borrowed from the Treasury since its inception?

Ms. PRICE. I think we have borrowed approximately $186 million. That sounds somewhere in the right ballpark. But I can double check that in just a second.

I am informed that we have outstanding in both debentures and preferred stock $290 million.

The CHAIRMAN. I was thinking it was around $300 million.

What is your default rate? What are the MESBICs' default rate with the firms that they invest in?

Ms. PRICE. Our default rate—our ultimate loss rate is about 11 percent, to the best of our ability. It is a little bit difficult to determine that.

The CHAIRMAN. Give me an example of one of your best successes?

Ms. PRICE. Well, we invested in, of course, Essence Magazine. We have done a number of cable, telecommunications type of deals. We invested in, maybe one that you have heard of, Reggie Lewis' McCall's Pattern deal, that he sold and then went on to buy Beatrice Foods.

The CHAIRMAN. Did you see that big story in the New York Times on him yesterday?

Ms. PRICE. Yes. In the early years, Reggie was the general counsel for the association when we first started. So he is well known in our industry.

We have invested in a variety of franchises across the country, from the Chicken George's to Wendy's to Hair Care, all types of franchisees.

The CHAIRMAN. Do Wendy's and Chicken George's, any of those, do they have a minority program for franchisees?

Ms. PRICE. Most of them have some sort of program. They may not be a specialized minority program, but many of them do have some specialized outreach programs that we have worked with—McDonald's, Burger King.

Some of the new ones, the new franchises, are good opportunities for us because it allows us to have territories and things like that for entrepreneurs.

The CHAIRMAN. Is Church's Fried Chicken minority owned?

Ms. PRICE. No. The one that was minority owned was Chicken George, which was in Baltimore, which we had invested in the franchisor. But that company unfortunately went into Chapter 11.

There are not any minority-owned franchisors right now in business at this time.

We have done some high-tech investing, high-tech, low-tech, looking for market niches, health care. You know, we are constantly looking, and we are seeing more and more talent in the minority community.

The CHAIRMAN. We had a very impressive gentleman before this Committee who had some sort of a high-tech firm—is it in Alexandria?

Ms. PRICE. Herb Wilkins, one of our investment companies?

The CHAIRMAN. Yes. Was he ever the recipient of a MESBIC loan?

Ms. PRICE. He runs a MESBIC. He is former chairman of the association and has been very active in the development of COSBI and the MESBIC part of COSBI.

The CHAIRMAN. Would you anticipate that MESBIC debentures be offered to Wall Street as a separate package from SBIC debentures?

Ms. PRICE. Well, the problem with that—and when we looked at that in the very early years—is the MESBIC Program is a very small piece of the total SBIC Program, and so that packaging our loans and that type will not be that attractive, because you are not talking about a large enough bulk, No. 1.

The CHAIRMAN. It will drive up the cost of borrowing?

Ms. PRICE. Right.

And No. 2, of course, you would not expect Wall Street to purchase subsidized debentures. There would have to be a mechanism to protect the integrity of those debentures going to the street.

So that is why in the early years when we looked at COSBI and when the regular SBIC's began to consider COSBI, we felt it was very important that we develop a mechanism so that we can operate within that frame. And that is what we did, in conjunction with NASBIC, in working on how our people would feel comfortable in COSBI.

So we made a conscious decision.

The CHAIRMAN. Are MESBIC's members of NASBIC?

Ms. PRICE. There are some MESBIC's that are also members of NASBIC, yes.

The CHAIRMAN. Joann, thank you very much for being with us today. It is a splendid statement.

Ms. PRICE. Thank you, Senator Bumpers.

The CHAIRMAN. We will stand in recess subject to the call of the Chair.

[Whereupon, at 3:20 p.m., the Committee was adjourned.]

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